DESCRIPTION OF ADDITIONAL TAX PROPOSALS SUBMITTED BY MEMBERS FOR WAYS AND MEANS COMMITTEE REVENUE RECONCILIATION CONSIDERATION

Prepared for the

HOUSE COMMITTEE ON WAYS AND MEANS

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of the

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a brief description of certain additional tax proposals submitted by Members for possible consideration by the Committee on Ways and Means in its markup of revenue reconciliation provisions.[2]

The first part describes provisions affecting principally higher-income taxpayers. The second part describes business reform provisions. Part three describes compliance provisions. The fourth part describes excise tax provisions, and the fifth part describes income tax rate provisions. Part six includes the Administration revenue proposals not already approved by the majority caucus on October 7.

An Appendix provides estimated budget effects of the revenue proposals included in this document.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Additional Tax Proposals Submitted by Members for Ways and Means Committee Revenue Reconciliation Consideration (JCX-13-87), October 13, 1987.

[2] For a description of the Administration's revenue proposals and certain other tax proposals, see Joint Committee on Taxation, Description of Administration Revenue Proposals, Expiring Tax Provisions, Estate Tax Deduction for ESOPs, and Estimated Tax Proposal (JCX-12-87), September 30, 1987.

I. PROVISIONS AFFECTING HIGHER-INCOME TAXPAYERS

A. Income Tax Provisions

1. Individual Income Tax Provisions

a. Child and dependent care credit: phase out credit; deny eligibility of overnight camp expenses

Present Law

Present law provides an income tax credit equal to up to 30 percent of certain employment-related child and dependent care expenses. For example, costs incurred by the taxpayer for a day care center or nursery school, a housekeeper or other home care, and summer camps (including overnight camps) are eligible for the credit if incurred to enable the taxpayer to work.

The amount of qualified expenses eligible for the credit is limited to $2,400 ($4,800 for the care of two or more individuals).

The 30-percent credit rate is reduced by one percentage point for each $2,000 (or portion thereof) of adjusted gross income (AGI) between $10,000 and $28,000. The credit rate is 20 percent for taxpayers with AGI exceeding $28,000.

Explanation of Provisions

1. The credit rate would be reduced by one percentage point for each $2,000 (or portion thereof) by which AGI exceeds $50,000. Under this provision, no credit would be allowed to taxpayers with AGI exceeding $88,000.

2. Costs incurred by taxpayers to send their child to an overnight camp would be ineligible for the credit.

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
1. Phase out the credit beginning at AGI of $50,000	(1)	0.3	0.4	0.7
2. Deny credit for overnight camp expenses	(1)	0.1	0.1	0.2

(1) Gain of less than $50 million.

See pp. 91-92 of the Revenue Options Pamphlet (JCS-17-87).

b. Interest expense deduction on home equity loans

Present Law

Under present law, personal interest (other than qualified residence interest) is not deductible, subject to a phase-in over the period 1987-1991. Under present law, a taxpayer may deduct interest on a loan secured by a lien on his or her residence, up to the amount of the original cost of the residence (plus improvements), and may also deduct the interest on certain loans secured by the residence incurred for educational or medical expenses up to the fair market value of the residence. The interest on such loans secured by the residence is deductible even though the loan proceeds are used for personal purposes. These loans are being advertised by lending institutions as "home equity loans".

Explanation of Provisions

Provision 1--(a) The debt eligible for the qualified residence exception would be limited to debt to acquire or improve the taxpayer's principal or second residence. Alternatively, an additional amount of interest on debt (not in excess of the fair market value of the residence) secured by the taxpayer's principal or second residence equal to (b) $5,000 of interest ($3,000 for unmarried individuals), or (c) $10,000 of interest ($6,000 for unmarried individuals) would be allowed.

Provision 2--The amount of debt eligible for the qualified residence exception would be limited to $1 million.

Provision 3--The amount of interest deductible as qualified residence interest under present law would be capped at $15,000 per year.

Provision 4--It would be expressly provided that boats and mobile homes used on a transient basis would be ineligible to qualify as second residences for purposes of the interest expense deduction.

Effective Date

The provisions would be effective for taxable years beginning after December 31, 1987, with respect to indebtedness incurred on or after the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Provision 1 (a)	0.2	1.7	1.8	3.8
(b)	0.1	0.4	0.5	1.0
(c)	(1)	0.3	0.3	0.6
Provision 2	(1)	0.3	0.3	0.6
Provision 3	0.2	0.9	1.0	2.1
Provision 4	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 93-95 of the Revenue Options Pamphlet (JCS-17-87).

c. Limit itemized deduction for nonbusiness real and personal property taxes

Present Law

Under present law, itemizers may deduct three types of State and local taxes--individual income taxes, real property taxes, and personal property taxes. (State and local sales taxes were made nondeductible under the Tax Reform Act of 1986, beginning in 1987.)

Real property taxes are deductible to the extent they represent proportional taxes on real property where the benefit accrues to the general public. To the extent real property taxes represent an assessment for improvements which benefit the taxpayer, they are not deductible. Personal property taxes are deductible only if imposed (1) on an annual basis, and (2) substantially in proportion to the value of the personal property that is subject to tax.

Real property taxes are imposed almost universally by localities. Some 26 States (or their subdivisions) impose taxes on some type of tangible property, such as boats or automobiles used for personal purposes.

Explanation of Provision

The aggregate amount of itemized deductions allowed in a year for real and personal property taxes (other than taxes incurred in a trade or business or investment activity) would be limited to (a) $5,000, or (b) $20,000.

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit deductions for the sum of real and personal property taxes at				
(a) $5,000	0.1	0.4	0.4	0.8
(b) $20,000	(1)	(1)	(1)	0.1

(1) Gain of less than $50 million.

See pp. 96-97 of the Revenue Options Pamphlet (JCS-17-87).

d. Limit itemized deduction for nonbusiness casualty and theft losses

Present Law

An itemized deduction is allowed for casualty and theft losses to the extent that each loss exceeds $100 and that the total amount of net casualty and theft losses exceeds 10 percent of the taxpayer's adjusted gross income (AGI).

Explanation of Provision

The otherwise allowable itemized deduction for casualty and theft losses in a year--i.e., the excess of the total amount of net casualty and theft losses (exceeding $100 each) over 10 percent of AGI--would be limited to $10,000. This limitation would not apply to casualty and theft losses of property that is used in a trade or business or in an income-production activity.

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
$10,000 limit on nonbusiness casualty and theft losses	(1)	(1)	(1)	0.1

(1) Gain of less than $50 million.

e. Limit certain miscellaneous itemized deductions

Present Law

Under present law, miscellaneous itemized deductions for any taxable year generally are allowed only to the extent that the aggregate of such deductions exceeds two percent of the taxpayer's adjusted gross income. In general, miscellaneous itemized deductions include certain unreimbursed employee business expenses, certain investment expenses, and expenses related to filing tax returns. The two-percent floor does not apply to specified categories of miscellaneous itemized deductions, such as moving expenses.

Explanation of Provision

The aggregate amount of otherwise allowable miscellaneous itemized deductions that are subject to the two-percent floor would be limited to $2,000. The $2,000 limit would not apply to those categories of miscellaneous itemized deductions that under present law are not subject to the two-percent floor.

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
$2,000 limit on certain miscellaneous itemized deductions	0.5	3.4	3.7	7.2

2. Employee Benefits; Pensions

a. Phase out exclusion for employee benefits with respect to high-income employees

Present Law

In general, employer-provided health coverage, group-term life insurance (up to $50,000 of coverage), and dependent care assistance (up to $5,000 per year) are excludable from an employee's income. These exclusions are conditioned, however, on the benefits being provided under a plan meeting certain nondiscrimination and qualification requirements.

Explanation of Provision

The exclusion from income of employer-provided health coverage, group-term life insurance, and dependent care assistance would be repealed for employees with compensation equal to or exceeding $100,000. The exclusions would be phased out between $90,000 and $100,000. The same phaseout of the exclusions or deductions would apply to self-employed individuals based on their earned income.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Phase out exclusion for employee benefits with respect to high-income employees	0.1	0.3	0.4	0.9

See pp. 111-112 of the Revenue Options Pamphlet (JCS-17-87).

b. Cap cash option under a cafeteria plan

Present Law

Under present law, compensation generally is includible when actually or constructively received. An amount is constructively received by a taxpayer if it is made available to the taxpayer.

Under an exception to the principle of constructive receipt, no amount is included in the income (or wages for FICA and FUTA purposes) of a participant in a cafeteria plan meeting certain requirements solely because, under the plan, a taxable benefit is available to the participant. Nontaxable benefits that may be available under a cafeteria plan include, for example, health coverage, group-term life insurance, and dependent care assistance.

Explanation of Provisions

1. The cafeteria plan exception to the constructive receipt principle would be limited to $500 per year for purposes of the income, FICA, and FUTA taxes. Thus, the amount of cash an employee can elect to receive without triggering income inclusion would be limited to $500. For example, if an employee has a choice between contributing $750 of salary toward the purchase of health insurance and receiving that $750 in cash, and if the employee elects to buy health insurance with the $750 of salary, $250 will be taxable to the employee. On the other hand, if the employee has the option of receiving $500 in cash or $500 in benefits and also may allocate an additional $250 among various benefits, but may not take the additional $250 in cash, then none of the benefits elected would be taxable.

A plan offering an employee a choice only among nontaxable benefits (other than cash equivalents) would not be affected by this cap.

2. Same as option 1., but limit the cafeteria plan exception to the constructive receipt principle to $1000 per year for purposes of the income, FICA, and FUTA taxes.

3. Same as option 1., but repeal the exception to the constructive receipt principle for FICA and FUTA purposes.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
1. Cap cash option under a cafeteria plan ($500 per year)	0.8	1.4	1.9	4.1
2. Cap cash option at $1000	0.1	0.2	0.3	0.7
3. Cap cash option at $500 and repeal exception for FICA and FUTA	1.2	2.1	3.0	6.3

See pp. 113-115 of the Revenue Options Pamphlet (JCS-17-87).

c. Modify definition of active participant for IRA rules

Present Law

Under present law, a taxpayer generally is permitted to make the maximum permissible deductible IRA contribution if the taxpayer (1) has adjusted gross income that does not exceed an applicable dollar amount or (2) is not an active participant. The term "active participant" generally means an individual who is an active participant in (1) a qualified plan, (2) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of the United States or a State or political subdivision, or (3) a tax-sheltered annuity (sec. 403(b)), simplified employee pension, or section 501(c)(18) plan.

In a recent Tax Court decision (Porter v. Commissioner, 88 T.C. No. 28 (March 5, 1987)), it was held that Article III judges are not employees of the United States and, therefore, are not active participants in a plan established for its employees by the United States. Whether or not an individual is an employee is also relevant for other purposes under the Code, such as for the exclusion of certain benefits from income and the eligibility for certain deductions.

Explanation of Provision

The decision in Porter v. Commissioner would be overturned and officers of the United States or of a State or political subdivision as described in the decision would be treated as employees for purposes of the Code and as active participants for purposes of the IRA deduction limit.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Modify active participant rules	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 122-123 of the Revenue Options Pamphlet (JCS-17-87).

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3. Passive Loss Rules

a. Treat farm losses like rental real estate losses

Present Law

Present law provides that deductions from passive trade or business activities, to the extent they exceed income from all such passive activities (exclusive of portfolio income), generally may not be deducted against other income. Suspended losses are carried forward and treated as deductions from passive activities in the next year, and are allowed in full when the taxpayer disposes of his entire interest in the activity. The provision applies to individuals, estates, trusts, and personal service corporations.

Rental activities are defined as passive activities. A special rule provides that up to $25,000 of losses from a rental real estate activity (generally, one in which the taxpayer actively participates) are allowed against other income for the year. The $25,000 amount is phased out between $100,000 and $150,000 of adjusted gross income.

Explanation of Provision

Losses from farming activities would be treated in the same manner as losses from rental activities, i.e. they would be treated as losses from passive activities for purposes of the passive loss rule and could not offset income from other activities prior to the time the farming activity is disposed of. The allowance of up to $25,000 of losses from certain rental real estate activities would be modified to include losses from farming activies of individuals who materially participate (within the meaning of the passive loss rule) in the farming activity. Thus, up to $25,000 of losses from the farming and rental real estate activities activities could offset other income. As under present law, the $25,000 amount would be phased out between $100,000 and $150,000 of adjusted gross income.

Effective Date

The provision would apply to taxable years beginnning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Treat farm losses like real estate losses	0.4	1.2	1.4	3.0

See pp. 156-157 of the Revenue Options Pamphlet (JCS-17-87).

b. Repeal exception from passive loss rule for oil and gas working interests

Present Law

Present law provides that deductions from passive trade or business activities, to the extent they exceed income from all such passive activities (exclusive of portfolio income), generally may not be deducted against other income. Suspended losses are carried forward and treated as deductions from passive activities in the next year, and are allowed in full when the taxpayer disposes of his entire interest in the activity. Passive activities generally include trade or business activities in which the taxpayer does not materially participate, as well as rental activities.

Under present law, a working interest in an oil or gas property is not treated as a passive activity, whether or not the taxpayer materially participates. A working interest for purposes of this provision means an interest with respect to an oil or gas property that is burdened with the cost of development and operation of the property and with respect to which the taxpayer's form of ownership does not limit the liability of the taxpayer.

Explanation of Provision

The rule applicable to oil and gas working interests would be repealed. Thus, a working interest in an oil or gas property with respect to which the taxpayer does not materially participate would be treated as a passive activity.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal working interest exception to passive loss rule	0.1	0.3	0.3	0.7

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4. Limit Deferral for Like-Kind Exchange for Real Estate to Gain of $100,000 Per Year

Present Law

An exchange of property, like a sale, generally is a taxable transaction. However, no gain or loss is recognized if property held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged solely for property of a like-kind that also is to be held for productive use in a trade or business or for investment.

In general, any kind of real estate is treated as of like kind with all other real estate. By contrast, different types of personal property (e.g., equipment or vehicles) are not treated as of like kind. Certain types of property, such as inventory, stocks and bonds, and partnership interests, cannot be used as like-kind property.

Explanation of Provision

The amount of gain that a person could defer from the exchange of real estate would be limited to $100,000 per year.

Effective Date

The provision would be effective for exchanges on or after the date of committee action, with an exception for exchanges pursuant to binding contracts in effect on the day before date of commitee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit deferral for like-kind exchange for real estate to gain of $100,000 per year	0.2	0.4	0.4	1.0

See pp. 240-241 of the Revenue Options Pamphlet (JCS-17-87).

5 Reduction in Individual and Corporate Tax Preferences

Present Law

A number of provisions in the income tax law and regulations provide economic incentives to the private sector or tax relief to particular kinds of taxpayers. These tax provisions, often referred to as preferences, generally take the form of exclusions, credits, deductions, and deferrals of tax liability.

Explanation of Provision

The value of tax preferences could be directly reduced by a specified percentage. Preferences that would be reduced include the credits for child and dependent care expenses, clinical testing expenses and producing fuel from nonconventional sources; the investment tax credit; the rehabilitation tax credit; energy tax credits; the targeted jobs tax credit; the alcohol fuels tax credit; the research credit; and the possesions tax credit. The reduction would apply to itemized deductions for individuals, deductions for ACRS, pollution control facility amortization, circulation expenditures, research and experimental expenditures, expenses for tertiary injectants, excess percentage depletion, intangible drilling costs, mining exploration and development expenses, business entertainment deductions, foreign convention attendance expenses, certain travel expenses, financial institution preferences, soil and water conservation expenditures, and the small life insurance company deduction.

The benefits of incentive stock options, foreign sales corporations, deferral for foreign controled corporations, tax exemption for credit unions, certain ESOP loans, lump-sum averaging, sales to ESOPs, and shipping income deferral also would be reduced. Also, the dollar limitations for the one-time housing gain exclusion, the foreign earned income exclusion, the expensing of depreciable property, amortization of reforestation expenditures, IRA deductions, employee gifts, luxury cars, and pension plan benefits and contributions would be reduced. The tax-exempt bond and low-income housing credit ceilings would be lowered. In addition, the alternative minimum tax rate also would be increased by a specified percentage.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

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Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
Reduction in individual and corporate tax preferences	1.2	11.4	12.2	24.8

B. Estate and Gift Taxes

1. Rates and United Credit

Present Law

The gift and estate taxes are unified, so that a single progressive rate schedule is applied to an individual's cumulative gifts and bequests. A unified credit of $192,800 is deducted from the gross gift or estate tax in arriving at the net tax payable. In effect, the credit exempts the first $600,000 of aggregate transfers from estate and gift taxes.

For 1987, the gift and estate tax rates begin at 18 percent on the first $10,000 of taxable transfers and reach 55 percent on taxable transfers over $3 million. For transfers occurring after 1987, the maximum gift and estate tax rate is scheduled to decline to 50 percent for taxable transfers over $2.5 million (On October 7, 1987, the Committee decided to make the estate and gift tax rates for 1987 permanent).

Explanation of Provisions

Provision 1

The benefit of the unified credit and of the tax brackets below 55 percent would be phased out for transfers exceeding $5 million. The gift and estate tax liability for transfers in excess of $5 million would be increased by five percent of such excess until the benefit of the unified credit and lower brackets is recaptured.

Provision 2

A 2-percent minimum estate tax would be imposed on the assets less liabilities held at death with no unified credit allowed.

Effective Date

The provisions would be effective for transfers occurring after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Phase out unified credit and lower rates beginning with estates of $5 million	(1)	0.3	0.5	0.8
2% death tax with no credit	(1)	0.8	1.0	1.8

(1) Gain of less than $50 million.

See pp. 258-260 of the Revenue Options Pamphlet (JCS-17-87).

2. Tax on Appreciation Passing at Death

Present Law

The cost or basis of property acquired from or passing from a decedent is its fair market value at the date of death (or alternate valuation date if that date is elected for Federal estate tax purposes). The basis of property acquired from or passing from the decedent is often referred to as a "stepped-up basis." Under the stepped-up basis rule, appreciation after the decedent acquired the property is not subject to income tax.

On the other hand, in the case of property acquired by gift, the donee's basis generally is the same as the donor's basis. The basis of property acquired by gift is often referred to as a "carryover basis."

Explanation of Provisions

Provision 1

An income tax would be imposed on the net appreciation in property passing from a decedent at his death. In order to exempt relatively small estates from the appreciation tax, that tax would be offset by an exemption or any unused portion of the decedent's unified credit. Property passing to a surviving spouse or to charity would not be subject to the appreciation tax, but would receive a carryover basis similar to that provided for transfers by gift. As under present law, the basis of all other property would be its fair market value at the date of death.

Provision 2

A flat 10-percent tax would be imposed on appreciation on assets includible in the estate. This tax would be imposed only to the extent that the taxable estate exceeds $1 million. Community property and property held in the entirety or in joint tenancy would be added to the estate for purposes of this tax. For property eligible for the marital deduction, the tax would be deferred until the surviving spouse transfers the property by gift or bequest. In no event would the tax imposed on that surviving spouse exceed ten percent of the spouse's estate.

Provision 3

The basis of an asset acquired from a decedent would be made equal to the decedent's basis in the asset (i.e., a carryover basis).

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Effective Date

The provisions would be effective for all transfers made after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Capital gains at death	(1)	4.9	5.3	10.2
10-percent minimum tax on lesser of amount of appreciation or amount of estate in excess of $1 million	(1)	0.3	0.5	0.8
Carryover basis	(1)	0.5	1.2	1.7

(1) Gain of less than $50 million.

See pp. 261-263 of the Revenue Options Pamphlet (JCS-17-87).

3. Life Insurance Exclusion

Present Law

The proceeds of a life insurance policy on the decedent's life are includible in the decedent's gross estate if (1) they are receivable by the executor or administrator, or payable to the estate, or (2) the decedent at his death (or at any time within three years of his death) possessed any "incidents of ownership" in the policy. Incidents of ownership include the power to change the beneficiary, to assign the policy, to revoke an assignment, to borrow against its cash surrender value, and to surrender or cancel it.

Explanation of Provision

The proceeds of any insurance policy receivable, directly or indirectly, by a member of the decedent's family would be included in the gross estate.

Effective Date

The provision would be effective for decedents dying after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal life insurance exclusion	(1)	0.3	0.4	0.7

(1) Gain of less than $50 million.

See pp. 263-264 of the Revenue Options Pamphlet (JCS-17-87).

4. Valuation of Property (Estate Tax Freezes and Minority Discount)

Present Law

Where an individual retains enjoyment of, or the right to income from, transferred property, his gross estate includes the full value of such property. Nonetheless, a decedent's gross estate does not include the full value of a corporation where the decedent gives his children common stock in the corporation and the decedent retains control over, and the income from, the corporation through his retention of preferred stock in that corporation. Thus, by giving his children common stock in his corporation, a taxpayer may transfer appreciation in corporate assets from his estate to his children without that appreciation being subject to Federal estate or gift tax. Removing future appreciation from estate taxation is known as an estate "freeze."

In valuing the estate, courts have found that partial interests in property are worth less than a proportionate amount of the whole and that blocks of corporate stock are worth less than a pro rata share of the corporate assets. They have allowed minority discounts even where related persons together own most or all of the underlying property.

Explanation of Provisions

If an owner of a substantial interest in an enterprise transfers a disproportionate share of the appreciation in the enterprise while retaining disproportionate control or income of that enterprise, the transferred interest would be included in his gross estate.

For purposes of estate and gift tax valuation, property held, directly or indirectly, by an individual or by members of such individual's family would be treated as held by one person.

Effective Date

The provisions would be effective for transfers occurring and decedents dying after December 31, 1987.

Budget Effect
[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Valuation of property	(1)	0.7	0.8	1.5

(1) Gain of less than $50 million.

See pp. 265-267 of the Revenue Options Pamphlet (JCS-17-87).

5. Change State Death Tax Credit to Deduction

Present Law

A dollar-for-dollar credit is allowed against the Federal estate tax for any estate, inheritance, legacy, or succession taxes paid to a State in respect of any property included in the gross estate for Federal estate tax purposes. Varying with the size of the adjusted taxable estate, the maximum credit begins at .8 of 1 percent for the portion of an estate less than $90,000 and increases to 16 percent for the portion of an estate exceeding $10,040,000.

Explanation of Provision

The credit for State death taxes would be converted into a deduction.

Effective Date

The provision would be effective for decedents dying after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Change State tax credit to deduction	(1)	0.4	0.5	0.9

(1) Gain of less than $50 million.

See p. 268 of the Revenue Options Pamphlet (JCS-17-87).

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II. BUSINESS REFORM PROPOSALS

A. Reduction in Corporate Tax Preferences

Present Law

Present law imposes an across-the-board cutback, generally ranging from 20 to 30 percent, on the corporate tax preferences relating to percentage depletion for coal and iron ore in excess of basis, excess bad debt reserves of banks, interest to acquire certain previously acquired tax-exempt bonds, FSC income, amortization of pollution control facilities, mining development and exploration expenditures, and intangible drilling costs of integrated oil companies.

Explanation of Provisions

Provision 1--A 10-percent cutback would be applied, in the case of corporate taxpayers, to the the possessions tax credit.

Provision 2--A 10-percent cutback would be applied, in the case of corporate taxpayers, to the credit for research expenditures.

Provision 3--The present-law cutback percentages would be increased by five percent in the case of corporate tax preferences for percentage depletion for coal and iron ore in excess of basis, FSC income, amortization of pollution control facilities, mining development and exploration expenditures, and intangible drilling costs of integrated oil companies.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Cutback section 936 by 10%	0.2	0.2	0.2	0.6
Cutback R&D credit by 10%	0.2	0.1	(1)	0.3
Increase section 291 cutback by 5%	0.1	0.1	0.1	0.2

(1) Gain of less than $50 million.

See pp. 88-90 of the Revenue Options Pamphlet (JCS-17-87).

B. Accounting Provisions

1. Repeal Completed Contract Method

Present Law

Taxpayers engaged in the production of property under a long-term contract must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. Under the percentage of completion method, income is reported based on the percentage of a contract completed during the year. Under the percentage of completion-capitalized cost method, 40 percent of a contract is reported according to the percentage of completion method, and 60 percent according to the completed contract method, under which income is reported in the year the contract is completed.

Certain small businesses may use the completed contract method fully with respect to contracts to be completed within two years.

Explanation of Provision

The percentage of completion-capitalized cost method of accounting for long-term contracts would be repealed. Thus, the full amount of all long-term contracts (other than contracts of small businesses exempted under present law) would be reported on the (100 percent) percentage of completion method.

Effective Date

The provision would be effective for contracts entered into after date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal completed contract method	0.8	1.6	2.0	4.4

See pp. 133-135 of the Revenue Options Pamphlet (JCS-17-87).

26.

2. Apply Section 265 to Holders of Installment Sales Obligations of State or Local Governments

Present Law

Under present law, if a taxpayer sells property to a State or local government in exchange for an installment obligation, interest on the obligation may be exempt from tax.

Present law generally provides that no deduction is allowed for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from tax. However, the Internal Revenue Service has ruled (Revenue Procedure 72-18) that interest on a corporation's indebtedness is not disallowed where the corporation acquires nonnegotiable tax-exempt obligations in the ordinary course of business for services performed for, or goods supplied to, State or local governments. In addition, disallowance is not required for non-financial institutions where tax-exempt obligations do not exceed 2 percent of average assets. This may result in the unlimited deduction of interest on indebtedness incurred or continued to carry tax-exempt installment obligations.

Explanation of Provision

Where a taxpayer sells property and receives in exchange a tax-exempt obligation, a portion of the taxpayer's interest deductions would be disallowed. The portion disallowed would be based on the ratio of the taxpayer's average tax-exempt debt to its average assets. The de minimus rule would be set at the lesser of $1 million or 2 percent of assets.

Effective Date

The provision would apply with respect to tax-exempt installment obligations acquired after December 31, 1987.

Budget Effect
[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Supply 265 to holders of installment sales obligations of State and local governments	(1)	0.1	0.1	0.2

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(1) Gain of less than $50 million.

See pp. 149-151 of the Revenue Options Pamphlet (JCS-17-87).

3. Below-Market Loans to Certain Continuing Care Facilities

Present Law

Under present law, certain loans that bear interest at below-market rates are treated as loans that bear interest at a market rate accompanied by a payment from the lender to the borrower that is characterized in accordance with the substance of the particular transaction (e.g., gift, compensation, dividend, etc.).

An exception from the below-market loan rules is provided for certain loans to certain "continuing care facilities." In exchange for the making of such below-market loans, individual lenders may receive housing, meals and other personal consumption items in addition to a promise of long-term nursing care if necessary.

Explanation of Provision

The below-market loan rules would apply to below-market loans made to continuing care facilities and other similar facilities that provide consumption items in connection with the making of the loan.

Effective Date

The provision would apply to below-market loans made after the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Below-market loans to certain continuing care facilities	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 152-153 of the Revenue Options Pamphlet (JCS-17-87)

4. Repeal Cash Method of Accounting for Farms With Gross Receipts Over A Certain Amount

Present Law

Entities engaged in the trade or business of farming may generally use the cash method of accounting for such trade or business. However, if the entity is a corporation (other than an S corporation or a family-owned corporation) or is a partnership with a C corporation as a partner and has gross receipts in excess of $1 million for any taxable year beginning after 1975, an accrual method of accounting must be used. In general, a family-owned corporation is one 50 percent or more of whose stock is owned by members of the same family. Certain closely held corporations substantially owned by two or three families on October 4, 1976, and at all times thereafter also qualify as family-owned for the purposes of this exception.

If the entity engaged in the trade or business of farming is a tax shelter, it may not use the cash method of accounting. Otherwise, a farming trade or business is not prohibited from the use of the cash method of accounting as a result of changes made in the Tax Reform Act of 1986.

Explanation of Provision

The use of the cash method of accounting would be denied to any entity engaged in the trade or business of farming with average annual gross receipts in excess of $5, $25, $50, or $100 million. Average annual gross receipts would be determined by averaging the gross receipts of the entity (or related and predecessor entities) for the previous three taxable years.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal cash accounting for farms with gross receipts				
over $5 million	0.2	0.3	0.3	0.8
over $25 million	0.1	0.2	0.2	0.6
over $50 million	0.1	0.2	0.2	0.5
over $100 million	0.1	0.1	0.1	0.3

See pp. 128-129 of the Revenue Options Pamphlet (JCS-17-87).

5. Require Current Accrual of Market Discount on Bonds

Present Law

In general, present law does not require current accrual of market discount, which is the economic equivalent of interest, by the holder of a bond. Thus, a taxpayer who purchases a bond after original issue at a price less than its face amount (or adjusted issue price in the case of a bond originally issued at a discount) does not, absent an election, include in income any portion of the discount prior to the redemption or other disposition of the bond. Current accrual is generally required, however, with respect to original issue discount.

Explanation of Provision

Market discount on a bond would be includible as interest income by the holder of the bond as such discount accrued. The amount of discount includible in a given taxable year would be computed using a simplified method (e.g., discount would be assumed to accrue on a straight-line basis), unless the holder elected to use the economic accrual method.

Effective Date

The provision would be effective for bonds acquired after the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Require current accrual of market discount on bonds	(1)	0.2	0.2	0.4

(1) Gain of less than $50 million.

See pp. 142-143 of the Revenue Options Pamphlet (JCS-17-87).

6. Amortization of Customer Base Intangibles

Present Law

No depreciation or amortization deductions are allowed with respect to property that is not a wasting asset or whose useful life cannot be estimated with reasonable accuracy. Such assets include goodwill and going concern value.

Taxpayers frequently take the position that a substantial portion of the purchase price of a business is allocable to assets that represent the value of the existing customer base and are said to have a determinable useful life as the customer base erodes. Evidence of continuing replacement of the customer base is often disregarded. In addition, the costs of such replacement are often not capitalized but are deducted currently. Such assets include, for example, customer and subscription lists; patient or other client records; the existing "core" deposits of banks; insurance in force in the case of an insurance company; advertising relationships and customer or circulation base in the case of a broadcast or newspaper business; other contracts or relationships reflecting the value of the customer base; and existing market share in the case of any business. Some taxpayers also deduct the cost of purchasing certain franchises or other assets with an indeterminate useful life, based on other interpretations of existing Code provisions.

Explanation of Provision

The provision would clarify that amortization, depreciation or similar deductions are denied for intangible assets that are renewing or for any intangible assets with an indeterminate useful life. Deductions for intangible assets representing the value of the existing customer base or market share would be denied.

Effective Date

The provision would apply to acquisitions after the date of committee action unless pursuant to a binding written contract.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Deny amortization	0.1	0.1	0.1	0.3

See pp. 146-148 of the Revenue Options Pamphlet (JCS-17-87)

7. Limitations on Deductibility of Certain Advertising Costs

Present Law

Selling expenses, including costs relating to advertising and promotion of a product, are treated as ordinary and necessary business expenses that are fully deductible in the year paid or incurred. There is no limitation on this rule based on the type of product advertised or promoted.

Explanation of Provisions

Provision 1

The provision would deny any deduction for advertising for, or promotion of, beer or wine products.

Provision 2

The provision would deny any deduction for advertising for, or promotion of, tobacco products.

Effective Date

The provisions would be effective for amounts paid or incurred in taxable years ending after December 31, 1987.

Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
1. Deny deduction for beer and wine advertising	0.3	0.4	0.5	1.2
2. Deny deduction for tobacco advertising	0.5	0.8	0.9	2.2

See pp. 138-139 of the Revenue Options Pamphlet (JCS-17-87).

8. Repeal of Vacation Pay Reserve

Present Law

Under present law, an accrual-method taxpayer generally is permitted a deduction in the taxable year in which all of the events have occurred that determine the fact of a liability and the amount thereof can be determined with reasonable accuracy. Nonetheless, in order to ensure the proper matching of income and deductions in the case of deferred benefits for employees (such as vacation pay earned in the current taxable year, but paid in a subsequent year), an employer generally is entitled to claim a deduction in the taxable year of the employer in which ends the taxable year of the employee in which the benefit is includible in gross income. Consequently, an employer generally is entitled to a deduction for vacation pay in the taxable year of the employee for which the pay (1) vests (if the vacation pay plan is funded by the employer) or (2) is paid and for amounts which vest or are paid within 2-1/2 months after the end of the employer's taxable year. Under a special rule, an employer can elect to deduct an amount representing a reasonable addition to a reserve account for vacation pay earned by employees before the close of the current year and paid by the close of that year or within 8-1/2 months thereafter.

Explanation of Provision

The special rule that permits taxpayers a deduction for additions to a reserve for vacation pay would be repealed. Under this proposal, deductions for vacation pay would be allowed in any taxable year for amounts paid, or funded amounts which vest, during the year or within 2-1/2 months after the end of the year.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal vacation pay reserve	0.1	0.1	(1)	0.2

(1) Gain of less than $50 million.

See pp. 136-137 of the Revenue Options Pamphlet (JCS-17-87).

C. Partnership Provisions

1. Master Limited Partnerships (MLPs)

Present Law

Under present law, a partnership is not subject to tax at the partnership level, but rather, income and loss of the partnership is subject to tax at the partner's level. A partner's share of partnership income is generally determined without regard to whether he receives any corresponding cash distributions.

Treasury regulations distinguishing partnerships from corporations currently have the effect that an association is not treated as a corporation (rather than a partnership) for Federal income tax purposes unless it has more than two corporate characteristics. The relevant corporate characteristics are: (1) continuity of life, (2) centralization of management, (3) liability for corporate debts limited to corporate property, and (4) free transferability of interests.

Explanation of Provision

Publicly traded limited partnerships would be treated as corporations for Federal income tax purposes. Publicly traded partnerships would include those whose interests are traded on existing exchanges (including over the counter) and those in which a market is effectively made.

Effective Date

The provision would be effective for partnerships formed or substantially expanded (or whose activities are substantially changed) after the date of committee action, or that become publicly traded after the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Treat publicly traded limited partnerships as corporations				

See pp. 191-193 of the Revenue Options Pamphlet (JCS-17-87).

2. Treatment of Portfolio Investments

Present Law

Under present law, deductions from passive trade or business activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Passive income does not include income such as interest and dividends from the holding of stocks and bonds, etc. ("portfolio income"). A limited partnership interest is treated as a passive activity and the income is not treated as portfolio income. Thus, except to the extent that Treasury may prescribe in regulations, income from limited partnerships may be offset by passive losses from other sources.

Explanation of Provisions

Provision 1.--Publicly offered limited partnerships would be treated as entities that do not pass through tax losses or deductions to limited partners, and limited partners' net income from the partnership would be treated as portfolio (rather than passive) income to the partners under the passive loss rule.

Provision 2.--The above provision would apply for publicly traded limited partnerships. Publicly traded limited partnerships would include those whose interests are traded on existing exchanges (including over the counter) and those in which a market is effectively made.

Effective Date

Provision 1 would be effective for partnerships formed and partnership interests acquired (including by contribution) after the date of committee action. Provision 2 would be effective as if enacted with the passive loss rule (i.e., effective for taxable years beginning after December 31, 1986).

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Provision 1 (publicly offered)				
Provision 2 (publicly traded)	0.1	0.1	0.2	0.4

See pp. 191-193 of the Revenue Options pamphlet (JCS-17-87).

3. Treatment of Certain Limited Partnerships

Present Law

Entity classification.--Treasury regulations distinguishing partnerships from corporations currently have the effect that an association is not treated as a corporation (rather than a partnership) for Federal income tax purposes unless it has more than two corporate characteristics. The relevant corporate characteristics are: (1) continuity of life, (2) centralization of management, (3) liability for corporate debts limited to corporate property, and (4) free transferability of interests. There is no general rule for distinguishing partnerships from corporations on the basis of whether or not the entity conducts active business activities.

Treatment under the passive loss rule.--Under present law, deductions from passive trade or business activities (within the meaning of the passive loss rule), to the extent they exceed income from such passive activities, generally may not be deducted against other income. Passive income does not include income such as interest and dividends from the holding of stocks and bonds, etc. (portfolio income"). A limited partnership interest is treated as a passive activity and the income is not treated as portfolio income. Thus, except to the extent that Treasury may prescribe in regulations, income from limited partnerships may be offset by passive losses from other sources.

Unrelated business income.--Tax-exempt organizations generally are subject to tax on unrelated business income. This generally includes income from any unrelated business that the organization conducts, but excludes certain rental and other income. Generally, a partner's distributive share of income from a partnership retains the same character as in the hands of the partnership (e.g., a partner's distributive share of partnership income includes his share of partnership rental income).

Partnership level audits and compliance.--Present law provides for partnership-level audit of partnership items, but generally does not provide for collection of partners' tax liability or other compliance measures at the partnership level.

Explanation of Provision

Entity classification.--Publicly traded limited partnerships that engage in active business activities would be treated as corporations for Federal income tax purposes. Publicly traded partnerships would include those whose interests are traded on existing exchanges (including over the counter) and those in which a market is effectively made.

Treatment under the passive loss rule.--Publicly traded limited partnerships that do not engage in active business activities would be treated as entities that do not pass through tax losses or deductions to limited partners, and limited partners' net income from the partnership would be treated as portfolio income to the partners under the passive loss rule.

Unrelated business income.--Tax-exempt organizations' distributive shares of income from any publicly traded limited partnership (that is not treated as a corporation for Federal income tax purposes) would be treated as unrelated business taxable income without regard to the underlying character of the income.

Partnership level audits and compliance.--Collection of partners' tax liability, and related measures for simplifying the administration of partnership level audits, would be imposed for publicly offered partnerships (including those required to file a notice under applicable securities rules).

Study of partnership entity classification.--A study would be conducted of the issue of treating publicly traded limited partnerships (and other partnerships that significantly resemble corporations) as corporations for Federal income tax purposes, including the issues of disincorporation and of opportunities for avoidance of the corporate tax. The study would be due January 1, 1989.

Effective Dates

Entity classification.--The entity classification provision would be effective with respect to partnerships formed or substantially expanded (or whose activities are substantially changed) after the date of committee action, or that become publicly traded and engage in active business activities after the date of committee action. The provision would apply to all publicly traded active limited partnerships for taxable years beginning after December 31, 1994.

Treatment under the passive loss rule.--The treatment of net income from publicly traded limited partnerships as portfolio income would be effective as if enacted with the passive loss rule, i.e., for taxable years beginning after December 31, 1986.

Unrelated business income.--The treatment of partnership income of tax-exempt organizations would be effective for income from partnership interests acquired (including by contribution) after the date of committee action.

Partnership level audits and compliance.--The provisions would be effective for taxable years beginning after December 31, 1987.

Budget Effect

1988	1989	1990	1988-90
Treatment of certain limited partnerships			

4. Partnership Level Collection of Partners' Tax Liability

Present Law

Present law provides for partnership-level audit of partnership items. Collection of a partner's tax liability attributable to partnership items, however, occurs at the partner rather than at the partnership level.

Explanation of Provision

Collection of partners' tax liability would be imposed at the partnership level in the case of the underreporting of income on the income tax return of a publicly offered partnership.

Effective Date

The provision would be effective for partnership taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Partnership level collection	--	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 191-193 of the Revenue Options Pamphlet (JCS-17-87).

5. Treatment of Tax-Exempt Partners

Present Law

Under present law, partnership income, gain, loss, deduction or credit (or items thereof) may be allocated under the partnership agreement, but if the allocation does not have substantial economic effect, then the partner's share is redetermined in accordance with his interest in the partnership.

Under present law, tax-exempt organizations generally are subject to tax on unrelated business income. In general, income from debt-financed property is treated as unrelated business income. An exception from the unrelated business income tax is provided, in the case of debt-financed real property, provided the property is not leased back to the seller and certain other requirements are met, even if, at the same time, income can be allocated to tax-exempt partners and losses to taxable partners.

Explanation of Provision

The exception from unrelated business income treatment in the case of debt-financed real property would apply where the property is held by a partnership including tax-exempt partners, only if partnership allocations to the organization are consistently the same for all items, and have substantial economic effect.

Effective Date

The provision would be effective for debt-financed property acquired after (and acquisition debt on such property incurred after) the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Modify allocations for debt-financed real property in partnerships including tax-exempt organizations	(1)	0.2	0.2	0.4

(1) Gain of less than $50 million.

See pp. 194-195 of the Revenue Options Pamphlet (JCS-17-87).

D. Mergers, Acquisitions and Corporate Transactions

1. Reduction of Tax Avoidance in Certain Corporate Dispositions

Present Law

Certain distributions to a controlling corporate shareholder (an 80-percent distributee) are not taxed to the distributing corporation in a liquidation. By contrast, a nonliquidating distribution to such a shareholder causes the distributing corporation to recognize gain, though the gain would be deferred if the two corporations were filing consolidated returns until a disposition of the distributed property or certain other events. Certain divisive distributions of corporate stock are also tax-free. A sale of stock of a subsidiary to a related corporation is "deemed" to be a dividend, in some instances producing results more favorable than an actual sale or an actual dividend.

Explanation of Provision

The provision would treat liquidating distributions to a corporate 80-percent distributee that are not taxed under present law in the same manner as nonliquidating distributions. Gain would specifically be deferred in the case of a liquidating distribution to a parent corporation filing a consolidated return with the distributing corporation, until triggered by a subsequent disposition or certain other events described in the consolidated return regulations. Certain rules for intragroup divisive stock distributions and the deemed dividend rules for corporations would be modified so that the results are not more favorable than an actual dividend.

Effective Date

The provision would be effective for distributions after the date of committee action.

Budget Effect

[Fiscal Years, billions of dollars]

	1988	1989	1990	1988-90
Reduction of tax avoidance in corporate dispositions	0.3	0.5	0.6	1.3

See pp. 171-173, 175-177 and 184-185 of the Revenue Options Pamphlet (JCS-17-87).

2. Debt Financing and Corporate Acquisitions

Present Law

In general, corporate earnings distributed as dividends on equity are taxed at both the corporate level (when earned by the corporation) and at the shareholder level (when distributed). By contrast, corporate earnings distributed in the form of interest on corporate debt bear no corporate-level tax because interest is deductible. The Code thus creates a tax incentive to replace equity financing with debt financing to the extent this can reduce corporate taxes.

Section 279 of the Code denies corporate interest deductions on certain indebtedness incurred to acquire stock or substantially all the assets of another corporation. In general, that section denies a deduction for interest exceeding $5 million on certain corporate acquisition indebtedness. Because the restrictions of this provision can be fairly easily avoided, it does not as a practical matter effectively restrict the substitution of debt for equity in an acquisition.

Explanation of Provision

Deductions generally would be denied for interest exceeding $5 million a year on debt directly or indirectly supporting either (1) the acquisition of the majority of the stock of another corporation or (2) the redemption of a majority of the issuer's stock.

Effective Date

The provision would be effective for acquisitions or redemptions after the date of committee action unless pursuant to a binding written contract, board action, shareholder approval, letter of intent, or tender offer, or public announcement to shareholders in effect on that date at all times thereafter. Such transactions would be grandfathered provided the acquisition or redemption is completed before January 1, 1989.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Debt financing and corporate acquisitions	0.4	0.6	0.7	1.7

See pp. 171-174 of the Revenue Options Pamphlet (JCS-17-87).

3. Corporate Raider Tax Act

Present Law

Gain on the sale or exchange of corporate stock is taxed at regular tax rates; for 1987, a special lower capital gains rate may apply in certain circumstances.

A buyer of a controlling interest in corporate stock is not generally required to be treated as if the acquired corporation had sold all of its underlying assets, though a buyer may elect such treatment. Requiring the buyer to treat a stock purchase as such an underlying asset sale can result in significant additional corporate level tax.

Corporate earnings distributed in the form of interest on corporate debt bear no corporate-level tax because interest is deductible.

Explanation of Provision

A person who has made or threatened a hostile tender offer would be subject to an additional 50-percent non-deductible excise tax on "greenmail" gain on stock held less than two years that is redeemed by the company.

The acquisition of 80 percent or more of the stock of a company would be treated as if the corporation had sold all of its underlying assets in the hands of the purchaser, if more than a significant portion of the stock was acquired pursuant to a hostile offer.

No interest deduction would be allowed for indebtedness incurred to acquire stock or assets of a corporation if 20 percent or more of the stock was acquired in a hostile purchase.

Effective Date

The additional 50-percent tax would apply to payments received after the date of enactment of the provision. The treatment as an asset acquisition in the hands of the purchaser would apply to acquisitions after the date of enactment of the provision. The denial of interest deductions would apply to debt incurred after the date of enactment of the provision.

Budget Effect

(Fiscal years, billions of Dollars)

	1988	1989	1990	1988-90
Certain hostile takeovers	0.1	0.1	0.1	0.2

4. Modify Computation of Earnings and Profits for Intercorporate Dividends and Basis Adjustments (Overrule Woods Investment Co. Case)

Present Law

In some cases, a corporation can sell stock of a subsidiary for an economic profit without paying tax. This is due to the operation of the consolidated return regulations, which the Tax Court held it must follow in the case of Woods Investment Co. v. Commissioner, 85 T.C. 274 (1985). Those regulations produce this result because they have never been amended to accommodate the impact of certain statutory changes to the definition of earnings and profits that were enacted for other purposes (to assure that individual shareholders could not avoid tax on distributions). In some cases involving accelerated depreciation, a benefit similar to the Woods result might still be obtained outside of consolidation, because a 1984 Code provision did not cover accelerated depreciation.

Explanation of Provision

In determining a parent corporation's basis in the stock of a subsidiary with which it files a consolidated return, the earnings and profits of the subsidiary would be determined without regard to the special adjustments otherwise required under the Code. Earnings and profits for this purpose would not include any cancellation of indebtedness income of the subsidiary not taken into account in computing taxable income. Outside a consolidated return context, the provision enacted in 1984 would be expanded to include adjustments for accelerated depreciation.

Effective Date

The provision would apply to stock held on or acquired after the date of committee action (i.e., to dispositions after that date.) The computation of gain or loss on such dispositons would be computed taking into account the principles of the amendment during the entire holding period of the stock.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Overrule Woods case	0.3	0.4	0.5	1.2

See pp. 166-168 of the Revenue Options Pamphlet (JCS-17-87).

5. Limit Consolidated Return Pass-Through

Present Law

Under present law, corporations may file consolidated tax returns if they are members of an affilated group of corporations. In general, a parent and a subsidiary corporation are members of an affiliated group for this purpose if the parent corporation owns stock of the subsidiary possessing at least 80 percent of the total voting power and value of all the subsidiary stock (excluding certain nonvoting preferred stock).

Under the consolidated return regulations, the consolidated tax return of a parent corporation and an affiliated subsidiary generally allows 100 percent of a subsidiary's losses to offset the parent's income, or, conversely, allows 100 percent of a subsidiary's income to be offset by the parent's losses, even though the parent may own less than 100 percent of the subsidiary's stock.

Explanation of Provision

If the affiliated group owns less than 100 percent of the stock of a subsidiary, the provision would deny consolidation of the percentage of the subsidiary's income or loss attributable to stock owned by nonmembers.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit consolidated return pass-through	0.3	0.4	0.4	1.0

See pp. 169-170 of the Revenue Options Pamphlet (JCS-17-87).

6. Tax Loss Mergers and Acquisitions

Present Law

Generally, the Code prohibits the direct sale of tax benefits from one corporation to another.

Nevertheless, there are a number of acquisition techniques through which taxpayers may attempt to transfer or "cash out" tax benefits that could not otherwise be used.

Explanation of Provisions

Built-in depreciation would be subject to the built-in loss rules of section 382.

The loss carryforwards of a corporation in bankruptcy would be reduced by the full amount of the excess of the debt cancelled in the proceeding over the fair market value of the stock given to creditors in exchange for debt.

Loss corporations would be precluded from using their losses to shelter built-in gains of an acquired company recognized within 5 years of the acquisition.

Effective Date

The built-in depreciation and stock for debt provisions would apply to ownership changes (as defined for purposes of section 382) after date of committee action. The provision preventing sheltering and resale of built in gain assets would apply to acquisitions after date of committee action. Transition would be provided for transactions pursuant to a binding written contract in effect on that date and at all times thereafter.

Budget Effect

[Fiscal years, billions of dollars]

	1988	**1989**	**1990**	**1988-90**
Tax benefit mergers	0.1	0.1	0.1	0.2

See pp. 178-179 of the Revenue Options Pamphlet (JCS-17-87).

7. Tax Benefited Transfers through Intercorporate Dividends Received Deduction (Including Preferred Stock Loss Transfers)

Present Law

Under present law, corporations owning less than 80 percent of the stock of a corporation are entitled to a deduction equal to 80 percent of the dividends received from a domestic corporation.(A 100 percent deduction may apply to dividends received by an 80-percent or more corporate parent).

Explanation of Provisions

Provision 1--The 80-percent dividends received deduction for any corporation owning less than 80 percent of the stock of the distributing corporation would be reduced to 75 percent of the amount of the dividend.

Provision 2--The 80-percent deduction for intercorporate dividends would be phased out for distributions to any corporation that does not have an ownership interest in the underlying business rising to the level of a direct investment. Specifically, the deduction would be denied unless the distributee's stock ownership exceeds 20 percent of the value and voting power of the distributing corporation.

Provision 3--The 80-percent dividends received deduction would be eliminated for dividends on stock that has certain non-stock characteristics--for example, nonvoting preferred stock that is not treated as stock for certain other purposes of the Code; stock that in substance provides mechanisms enhancing the likelihood that principal will be recovered or a dividend level maintained; or stock that in substance has certain redemption or secured interest characteristics.

Effective Date

Provision 1 would apply to dividends paid after December 31, 1987.

Provision 2 would phase down the dividends received deduction 5 percent each year, beginning with dividends paid after December 31, 1987.

Provision 3 would apply to stock issued after date of committee action.

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Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Provision 1	0.1	0.2	0.2	0.6
Provision 2	[1]	0.1	0.4	0.5
Provision 3	0.1	0.3	0.5	0.8

See pp. 163-165 of the Revenue Options Pamphlet (JCS-17-87)

8. Limitations on Net Operating Loss Carryforwards of Corporations Following Worthless Securities Deduction By Shareholders

Present Law

A deduction is allowed for any loss sustained during the taxable year as a result of securities held by the taxpayer becoming worthless. It has been held that, notwithstanding the fact that a worthless stock deduction has been claimed by parent corporation with respect to stock of a nonconsolidated subsidiary, the net operating loss carryforwards of the subsidiary survive and may be used to offset future income of the subsidiary. Textron, Inc. v. United States, 561 F.2d 1023 (1st Cir. 1977).

Loss carryforwards of a corporation are limited if there is a more-than-50-percent change in the ownership of its stock during the relevant testing period. The amount of losses that may be used annually to offset post-change income of the corporation is equal to a prescribed rate of return on the net value of the corporation at the time of the change of ownership.

Explanation of Provision

If a worthless securities deduction is claimed by a shareholder of a loss company, the shareholder would be treated as having sold the stock to an unrelated person for purposes of applying the loss limitations of section 382. Thus, if such a deduction is claimed during the testing period by persons holding more than 50-percent of a loss corporation's stock, net operating loss carryovers of the corporation arising prior to the change generally could not be used to offset the corporation's post-change income.

Effective Date

Worthless securities deductions after date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit on loss carryforwards	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 182-183 of the Revenue Options Pamphlet (JSC-27-87).

9. Denial of Graduated Tax Rates for Personal Service Corporations

Present Law

Under present law, beginning July 1, 1987, corporations are generally subject to a tax at the rate of 34 percent. However, for corporations with a taxable income below $335,000, graduated rates are provided. These rates are 15 percent on taxable income not over $50,000, and 25 percent on taxable income over $50,000 and not over $75,000, with the benefits of these lower rates phased out as taxable income increases from $100,000 to $335,000.

Explanation of Provision

The benefits of the graduated corporate rates would be denied to personal service corporations. A personal service corporation is a corporation substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and substantially all the stock of which is held by the employees performing services for the corporation.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Denial of graduated rates for personal service corporations	0.1	0.1	0.1	0.3

See p. 188 of the Revenue Options Pamphlet (JCS-17-87).

10. LIFO Recapture on Conversion from C Corporation to S Corporation

Present Law

In general, gain realized when a C corporation liquidates is subject to corporate level tax. If a C corporation elects to convert to S corporation status and holds assets with a net unrealized "built-in gain" (that is, with a value in excess of basis) at the time of its conversion, the built-in gain is subject to a separate corporate-level tax to the extent it is realized within ten years after the conversion.

The Internal Revenue Service has stated that the inventory method used by a taxpayer for tax purposes shall be used in determining whether goods disposed of following a conversion to S corporation status were held by the corporation at the time of conversion. Thus, a C corporation using the last-in, first-out (LIFO) method of accounting for its inventory which converts to S corporation status will not be taxed on the built-in gain attributable to LIFO inventory to the extent it does not invade LIFO layers during the ten-year period following the conversion.

Explanation of Provision

A C corporation using the LIFO method which elects S corporation status would be required to include in income the LIFO recapture amount (that is, the excess of the inventory's value using a first-in, first-out (FIFO) flow assumption over its LIFO value on the date of the conversion) upon conversion.

Effective Date

The provision would apply to S elections made after date of committee action.

Budget Effect

(Fiscal years, billions of dollars)

	1988	**1989**	**1990**	**1988-90**
LIFO recapture on C to S conversions	0.2	0.2	0.2	0.7

See pp. 189-190 of the Revenue Options Pamphlet (JCS-17-87).

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E. Minimum Tax Provisions

Present Law

Taxpayers are subject to an alternative minimum tax payable, in addition to all other tax liabilities, to the extent it exceeds the taxpayer's regular tax. The tax is imposed at a flat rate (20 percent for corporate taxpayers, 21 percent for othrs) on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income, increased or decreased by certain adjustments and preferences.

In the case of a corporate taxpayer, one-half of the excess of pre-tax book income of a corporation over other alternative minimum taxable income is a preference for taxable years beginning in 1987 to 1989. For taxable years beginning after 1989, three-fourths of the excess of adjusted current earnings over other alternative minimum taxable income is a preference. Adjusted current earnings includes as a preference any change in LIFO inventory reserves.

Explanation of Provisions

1. Additions to LIFO inventory reserves, which would be a preference to corporate taxpayers under the adjusted current earnings provision, would also be a preference for noncorporate taxpayers.

2. 100 percent of the excess of book (for taxable years beginning before 1990) or adjusted current earnings (for taxable years beginning after 1989) over other alternative minimum taxable income would be a preference for corporate taxpayers.

3. 100 percent of the excess of adjusted current earnings over other alternative minimum taxable income would be a preference for corporate taxpayers. The book income preference would be repealed.

4. The individual minimum tax rate would be increased to 25 percent.

5. The corporate minimum tax rate would be increased to 25 percent.

6. Unrelated businesses would prohibited from consolidating for puroposes of the minimum tax.

7. Require adjustment of book income so that items of income and deduction related to certain discontinued operations, extraordinary events or material unusual or infrequently occurring events are recognized at the same time as such items are recognized for alternative minimum tax

purposes. Effective as if included in the Tax Reform Act of 1986, as to events arising in taxable years beginning after 1984 and before 1990.

Effective Date

The provisions (other than provision #7) would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
1. Treat change in LIFO reserve as noncorporate preference				
2. Increase book and adjusted current earnings preference to 100 percent	2.8	5.0	2.7	10.5
3. Increase adjusted current earnings to 100 percent, 1/1/88 (replace book)	1.1	2.0	1.8	4.8
4. Increase individual rate to 25 percent	0.8	3.7	2.7	7.1
5. Increase corporate rate to 25 percent	2.8	4.8	5.1	12.7
6. Prohibit consolidation				
7. Require book timing of certain material item to follow alternative minimum tax timing				

See pp. 243-245 of the Revenue Options Pamphlet (JCS-17-87).

F. Foreign Tax Provisions

1. Title Passage Source Rule and 50-50 Production/Marketing Split

Present Law

In general, income attributable to the marketing of inventory property by U.S. residents generally has its source where title to the property passes to the purchaser (the "title passage" rule).

Certain income derived from the manufacture of products in the United States and their sale elsewhere is treated as half U.S. and half foreign source under Treasury regulations.

Explanation of Provision

The title passage rule would be repealed and marketing income from sales of inventory generally would be sourced in the seller's residence country. An exception to this general rule would apply if the seller maintains a fixed place of business outside the United States, the fixed placed of business participates materially in the sale generating the income, and the income is subject to an effective rate of income tax of at least 10 percent in the country in which the office is located. However, marketing income from sales to related foreign persons would be sourced in the United States, unless the seller produces the goods outside the United States.

The amount of income allocable to production activity would be at least 50 percent of the total income from a sale with regulatory authority provided to the Secretary to increase the amount of income allocable to production activity.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal title passage source rule	0.3	0.7	0.7	1.7

See pp. 206-208 of the Revenue Options Pamphlet (JCS-17-87).

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2. Per-Country Foreign Tax Credit Limitation

Present Law

Taxpayers may take a dollar-for-dollar credit for foreign taxes they pay, but separate kinds of income are isolated so that taxpayers cannot cross-credit, that is, use foreign taxes imposed on one kind of income to offset U.S. tax on another kind of income.

Explanation of Provision

In line with the President's 1985 Tax Reform proposal, the foreign tax credit would be limited on a per-country basis, so that foreign taxes imposed on income earned in one country could not offset U.S. tax on income earned in another country.

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Per-country foreign tax credit limitation	0.6	1.7	2.0	4.3

3. Income from Runaway Plants

Present Law

U.S. persons that conduct foreign operations through a foreign corporation generally pay no U.S. tax on the income from those operations until the foreign corporation pays a dividend to its U.S. owners. The foreign tax credit may reduce or eliminate the U.S. tax on those dividends, however.

Deferral of U.S. tax on income of a U.S. corporation's foreign subsidiary is not available for certain kinds of income, including "foreign personal holding company income" (such as interest and dividends, net gains from sales of stock and securities, and some rents and royalties), certain sales and services income, and certain other kinds of tax haven income.

Explanation of Provision

The provision would repeal deferral for (that is, impose current tax on) income from "runaway plants," that is, income that a U.S. corporation's foreign subsidiary earns from manufacturing goods for use or consumption in the United States. This income, as well as allocable interest and royalties paid by a foreign subsidiary, would be subject to a separate foreign tax credit limitation, so that, for example, foreign taxes imposed on other income could not offset the U.S. tax on this income. this separate limitation would apply not only to income that foreign subsidiaries of U.S. taxpayers earn, but also to similar income earned directly by U.S. taxpayers.

Effective Date

This provision would apply for taxable years beginning after 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Income from runaway plants	0.1	0.2	0.2	0.6

See pp. 209-210 of the revenue options pamphlet (JCS-17-87).

4. Repeal Deferral on Foreign Income

Present Law

U.S. persons that conduct foreign operations through a foreign corporation generally pay no U.S. tax on the income from those operations until the foreign corporation pays a dividend to its U.S. owners. The foreign tax credit may reduce or eliminate the U.S. tax on those dividends, however.

Deferral of U.S. tax on income of a U.S. corporation's foreign subsidiary is not available for certain kinds of income, including "foreign personal holding company income" (such as interest and dividends, net gains from sales of stock and securities, and some rents and royalties), shipping income, oil-related income, certain sales and services income, and certain other kinds of tax haven income.

Explanation of Provision

The provision would repeal deferral for (that is, impose current tax on) all income derived by controlled foreign corporations.

Effective Date

The provision would apply for taxable years beginning after 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal deferral on foreign income	0.5	1.0	1.2	2.7

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5. Treatment of South African Income

Present Law

Foreign tax credits and certain other benefits are denied with respect to income attributable to activities of the taxpayer conducted in certain foreign countries whose current governments support terrorism, do not have diplomatic relations with the United States, or are unrecognized by the United States. Countries that are currently on this list are Afghanistan, Albania, Angola, Cambodia, Cuba, Iran, Libya, North Korea, Syria, Vietnam, and South Yemen. The other denied benefits include deferral and cross-crediting of other countries' taxes against U.S. taxes on income from these countries.

The comprehensive anti-apartheid act of 1986 imposes certain measures on South Africa, including economic measures such as the termination of the U.S.-South Africa tax treaty, to undermine apartheid.

Explanation of Provision

The provision would subject South African operations to the same tax treatment currently given to operations in the countries listed above.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987. The provision would terminate once the South African government had taken the steps that trigger termination of the measures of the anti-apartheid act to undermine apartheid.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Treatment of South African income	(1)	(1)	(1)	0.1

(1) Gain of less than $50 million.

See pp. 216-218 of the revenue options pamphlet (JCS-17-87).

6. Withholding Tax on Interest Paid to Foreigners

Present Law

If a foreigner's U.S. source interest income is not effectively connected with a U.S. trade or business, it is exempt from U.S. tax if it (1) qualifies for a general Code exemption, added in 1984, that applies to "portfolio interest," (2) is paid on a bank deposit, (3) constitutes short-term original issue discount, or (4) qualifies for a treaty exemption.

Explanation of Provision

A 5-percent withholding tax would be imposed on U.S. source interest income paid to foreign investors. That tax would override treaties only in cases of "treaty shopping," that is, use of one country's treaty by persons who are not residents of that country.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
5-percent withholding tax on interest paid to foreigners	(1)	0.2	0.3	0.5

[1] Gain of less than $50 million.

See pp. 211-212 of the revenue options pamphlet (JCS-17-87).

7. Prohibit foreign interest stripping

Present Law

A U.S. corporation that belongs to owners exempt from U.S. tax may deduct tax-free payments to them. For example, a foreign-owned U.S. corporation may be able to reduce its U.S. taxable income by making interest or royalty payments to related foreign persons. The payor can normally deduct those payments from U.S. taxable income. A U.S. income tax treaty (with the recipient's home country) may limit or even prohibit U.S. taxation of those payments in the hands of the recipient.

In addition, characterization of payments that are contingent on an increase in value of an asset ("equity kickers") or on profits in excess of a stipulated amount ("net profits interest") as interest allows a foreign person to extract income realized in the United States in the form of deductible interest, which may be free of U.S. tax. By contrast, if the contingent payment is characterized as reflecting equity ownership, some U.S. tax may be collected.

Similar situations can arise in the case of U.S. tax exempt persons.

Explanation of Provisions

1. The debt-equity ratio of a U.S. subsidiary would be limited to that of its foreign or other tax exempt owner. Absent a showing of the owner's debt-equity ratio, the deduction for interest payments by a subsidiary to its tax exempt would be limited to 50 percent of pre-interest deduction income.

2. So-called "interest" payments to exempt recipients that are actually contingent on an increase in the value of an asset or on additional profits would not benefit from tax reductions that apply to interest.

Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
Prohibit foreign interest stripping......................	([1])	0.1	0.1	0.2

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[1] Gain of less than $50 million.

See pp. 213-215 of the revenue options pamphlet (JCS-17-87).

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8. End Netherlands Antilles Treaty Exemption (Except for Eurobonds)

Present Law

In the summer of 1987, the Treasury Department terminated the tax treaty between the United States and the Netherlands Antilles, except for the provisions limiting the taxation of interest. The provisions that remain in force generally exempt interest paid by U.S. persons to Antilles persons.

Explanation of Provision

The remaining provisions of the Netherlands Antilles treaty would be terminated. In line with a Treasury Department proposal, there would be a statutory exemption for interest on certain outstanding Eurobonds that would be exempt if the treaty had remained in effect.

Effective Date

The provision would be effective for interest paid after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
End Netherlands Antilles treaty exemption (except for Eurobonds)	*	*	*	*

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* Gain of less than $50 million.

G. Insurance Provisions

1. Treatment of Tax-Advantaged Investments in Life Insurance and Annuity Contracts

Present Law

Treatment of distributions.--Distributions under a life insurance contract that are made prior to the death of the insured generally are treated first as a recovery of the taxpayer's basis in the contract and then as income.

By contrast, distributions under an annuity contract prior to the annuity starting date generally are treated as currently taxable to the extent of previously untaxed income on the contract (i.e., income first, then basis).

Treatment of loans.--Amounts borrowed under a life insurance contract are not treated as distributions to the policyholder and, as a result, are not taxable, even though the policyholder has current use of the money.

Amounts borrowed under an annuity contract, on the other hand, are treated as distributions under the contract and are treated as received first out of income on the contract.

Early distribution tax.--Distributions under a life insurance contract are not subject to an early distribution tax.

Distributions under an annuity contract or a qualified retirement plan that are made before the taxpayer attains age 59-1/2 are generally subject to an early distribution tax. The amount of the tax equals 10 percent of the portion of the distribution that is includible in gross income.

Definition of life insurance.--Under present law, a life insurance contract is eligible for favorable tax treatment to the policyholder if the contract meets either of two statutory tests (the "cash value accumulation" test or the "guideline premium/cash value corridor" test). Under these definitional tests, investment income on a life insurance contract that has too large an investment component is treated as ordinary income received or accrued by the policyholder during the year.

Explanation of Provisions

Provision 1: Treatment of pre-death distributions and loans under life insurance and annuity contracts

Treatment of distributions.--Distributions under life insurance contracts prior to the death of the insured would be treated similarly to distributions under annuity contracts prior to the annuity starting date (i.e., income first, to the extent that the net surrender value exceeds the policyholder's investment in the contract).

Treatment of loans.--Loans under life insurance contracts would be treated as distributions under the contract and, under the new basis recovery rule, would be treated as income first and then recovery of basis.

Early distribution tax.--An additional 10-percent income tax would be imposed on the portion of any distribution under a life insurance contract that is includible in income. This additional tax would not apply if a distribution occurs (i) after the holder of the contract attains age 59-1/2; (ii) on account of the holder's disability; or (iii) as part of an annuity-type distribution over the holder's life expectancy.

Provision 2: Treatment of loans under life insurance contracts

New loans under life insurance contracts would receive the same treatment as loans under annuity contracts (i.e., loans would be treated as distributions under the contract prior to the death of the insured, as income first before basis recovery, and as subject to an early distribution tax).

Provision 3: Definition of investment-oriented life insurance

The definition of life insurance would be narrowed for newly issued policies to provide that significantly investment-oriented life insurance policies, such as single-premium life insurance policies, would not be treated as life insurance for Federal income tax purposes and, therefore, the investment earnings on the policy would be currently included in the policyholder's income. If the amount of the premium in any year substantially exceeds the amount needed for level premium funding of the death benefit, or the income earned on the contract is from high-risk or high-return investments, then the contract would not be treated as life insurance.

Effective Dates

Provision 1.--The provision would apply to distributions and loans that occur after October 7, 1987 (the date of introduction of H.R. 3441), but only to the extent that the amount of the distribution or loan is allocable to investment in the contract after October 7, 1987.

Provision 2.--The provision would apply to loans after the date of committee action.

Provision 3.--The provision would apply to contracts issued after the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1998-90
1. Treatment of pre-death distributions and loans under life insurance and annuity contracts	(1)	0.1	0.2	0.3
2. Treatment of loans under life insurance contracts	(1)	(1)	(1)	(1)
3. Definition of investment-oriented life insurance	0.1	0.2	0.2	0.4

(1) Gain of less than $50 million.

See pp. 221-227 of the Revenue Options Pamphlet (JCS-17-87).

2. Interest Rate Used in Computing Reserves for Life Insurance and Annuity Contracts

Present Law

Under present law, the discount rate in computing life insurance tax reserves is the prevailing State assumed interest rate (generally, the highest rate for computing insurance reserves under the state insurance laws of 26 or more States). By contrast, under present law, tax reserves for unpaid losses of property and casualty insurance companies are subject to discounting by applying the applicable Federal rate (AFR) of interest (specifically, the average of the applicable Federal mid-term rates for the most recent 60-month period beginning after July 31, 1986).

Explanation of Provision

The interest rate used in determining reserves for life insurance and annuity contracts would be the greater of (1) the prevailing State assumed interest rate or (2) the AFR.

Effective Date

The provision would apply to life insurance and annuity contracts issued after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Require use of AFR for reserve deductions under life insurance rules	0.1	0.1	0.1	0.2

See pp. 221-227 of the Revenue Options Pamphlet (JCS-17-87).

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3. Deduction for Reserves of Life Insurance Companies Limited to Surrender Value

Present Law

Under present law, a life insurance company is allowed a deduction for a net increase in life insurance reserves (taking into account both premiums and assumed interest credited to the reserves). Life insurance reserves are defined to include amounts set aside to mature or liquidate future unaccrued claims arising from life insurance, annuity, and noncancellable accident and health insurance contracts that involve, at the time with respect to which the reserve is computed, life, accident, or health contingencies. Present law provides that the amount of the life insurance reserves for any contract is the greater of the statutorily prescribed amount, or the net surrender value of the contract.

Explanation of Provision

Insurance companies would be prohibited from deducting increases to reserves for newly issued life insurance or annuity contracts to the extent that the reserve exceeds the net surrender value of the contract.

Effective Date

The provision would be effective with respect to reserves for life insurance or annuity contracts issued after the date of committee action, in taxable years beginning after December 31, 1987. Any reduction to the opening reserve in the first taxable year would be included in income ratably over a 10-year period.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit reserves of life insurance companies to surrender value	(1)	0.1	0.1	0.2

See pp. 221-227 of the Revenue Options Pamphlet (JCS-17-87).

(1) Gain of less than $50 million.

4. Minimum Tax Treatment of Mutual Life Insurance Companies

Present Law

In computing the corporate alternative minimum tax, 50 percent of the excess of the adjusted net book income of a taxpayer over the unadjusted alternative minimum taxable income of the taxpayer is included in income (the "book income" preference). Under the book income preference, mutual life insurance companies are not required to include in income the differential earnings amount, an amount included in their regular taxable income that is intended to take account of the deductibility of policyholder dividends that represent a return of company earnings. Stock companies do not include a differential earnings amount in their regular taxable income. Thus, mutual companies are likely to have a smaller difference between book income and alternative minimum taxable income than are stock companies, and consequently are less likely than stock companies to incur tax liability under the corporate alternative minimum tax.

Explanation of Provision

An adjustment would be added to the calculation of book income of mutual life insurance companies to include the differential earnings amount in their book income.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Modify minimum tax treatment of mutual life insurance companies	(1)	(1)	0.1	0.1

(1) Gain of less than $50 million.

See pp. 234-235 of the Revenue Options Pamphlet (JCS-17-87).

5. Treatment of Investment Income of Foreign Insurance Companies

Present Law

In the case of a foreign life insurance company, any income from sources outside the United States that is attributable to its United States business is treated as effectively connected with the conduct of a United States trade or business and, thus, is subject to United States tax. In addition, present law requires that income effectively connected with the conduct of a life insurance business in the United States be increased by an imputed amount to the company, if its surplus held in the United States is insufficient in relation to a percentage of its total insurance liabilities on its United States business. The purpose of this imputation rule is to prevent foreign life insurance companies from artificially reducing the amount of investment income subject to tax in the United States.

Explanation of Provision

The rules for determining the amount of investment income that is effectively connected with the conduct of a life insurance business in the United States would be extended to foreign property and casualty insurance companies. In addition, the imputation rule would be strengthened to prevent foreign insurance companies from artificially decreasing the amount of investment income subject to tax in the United States.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Amend rules relating to taxation of investment income of foreign insurance companies	(1)	(1)	(1)	0.1

(1) Gain of less than $50 million.

See pp. 232-233 of the Revenue Options Pamphlet (JCS-17-87).

6. Treatment of Certain Insurance Syndicates

Present Law

Pursuant to a closing agreement between the IRS and the members of an insurance organization formed under the laws of the United Kingdom, these members are provided a three-year deferral of underwriting income or loss, consistent with the organization's traditional accounting method.

Explanation of Provision

In the case of a person who is a member of an organization formed under the laws of the United Kingdom to write insurance or reinsurance, the deferral currently allowed pursuant to the closing agreement would be prohibited. Income and loss would be subject to tax in the U.S. and would be calculated annually in accordance with the principles generally applicable to property and casualty insurance companies.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Modify treatment of certain insurance syndicates	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 236-237 of the Revenue Options Pamphlet (JCS-17-87).

7. Amortize Agents' Commissions and Other Premium Acquisition Expenses

Present Law

Under present law, life insurance companies generally deduct agents' commissions and other premium acquisition expenses when paid even though a portion of the premium income that relates to such expenses will be received in future taxable years.

Explanation of Provision

Agents' commissions and other premium acquisition expenses relating to life insurance contracts, annuity contracts, and endowment contracts would be capitalized and amortized over a period of 10 years with a taxpayer election to establish a shorter period based on the average period that premiums are received with respect to such contracts.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Amortize agents' commissions and other premium acquisition expenses	0.1	0.2	0.3	0.5

See pp. 238-239 of the Revenue Options Pamphlet (JCS-17-87).

8. Foreign Life Insurance Company Consolidation

Present Law

Under present law, if one or more life insurance companies file a consolidated return with one or more nonlife insurance companies, a special rule limits the use of certain losses against the income of the life insurance affiliates. The limitation is equal to the lower of (1) 35 percent of the consolidated net operating loss of the nonlife insurance affiliates, or (2) 35 percent of the taxable income of the life insurance company affiliates.

Income from foreign life insurance corporations that are owned by nonlife insurance affiliates is not treated as life insurance affiliate income for purposes of the loss limitation.

Explanation of Provision

Income from controlled foreign life insurance corporations would be treated as life insurance affiliate income for purposes of the loss limitation.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
Foreign life insurance company consolidation	(1)	(1)	(1)	0.1

(1) Gain of less than $50 million.

See pp. 228-229 of the Revenue Options Pamphlet (JCS-17-87).

H. Depreciation Provisions

1. Limitations on depreciation deductions for luxury automobiles

Present Law

Depreciation deductions for luxury automobiles are subject to fixed dollar limitations. The limitations are $2,560 for the first taxable year in the recovery period, $4,100 for the second taxable year, $2,450 for the third taxable year, and $1,475 for each succeeding taxable year. The limitations are inapplicable to automobiles that are leased or held for leasing by any person regularly engaged in the business of leasing automobiles. A lessee's deductions for rentals are subject to reduction but only if the lease term is 30 days or more. The surrogate limitation imposed on lessees requires the prescription of special tables by the Internal Revenue Service.

Explanation of Provision

The limitations for luxury automobiles would be imposed directly on the owner of leased automobiles.

Effective Date

The provision would apply to property placed in service on or after the date of Committee action.

Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
Depreciation for luxury autos	(1)	0.1	0.2	0.3

(1) Gain of less than $50 million.

See pp. 202-203 of the Revenue Option Pamphlet (JCS-17-87).

2. Increase cost recovery period for single-purpose agricultural structures

Present Law

For purposes of ACRS and the alternative depreciation system, single-purpose agricultural and horticultural structures (described in ADR class 01.3) are assigned an ADR midpoint life of 15 years. As a result of assigning a 15-year midpoint, the cost of this property is recovered over seven years under ACRS.

Explanation of Provision

Under ACRS, single-purpose agricultural and horticultural structures (except greenhouses and mushroom houses) would be assigned an ADR midpoint life of 24 years. Hence the cost of such property would be recovered over 15 years using the 150-percent declining balance method.

Effective Date

The provision would be effective for property placed in service after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

1988	1989	1990	1988-90
*	*	*	0.1

*/ Gain of less than $50 million.

I. Unrelated Business Income Tax (UBIT) on Net Investment Income of Trade Associations

Present Law

Dividends, interest, and other investment income earned by a tax-exempt organization generally are excluded from unrelated business income subject to the UBIT (unless derived from debt-financed property or certain controlled entities).

However, in the case of social clubs, VEBAs, and certain other mutual benefit organizations, the UBIT applies to all gross income--including investment income--other than "exempt function income," such as membership receipts. The legislative history of this rule indicates that the Congress concluded that if investment income could be received tax-free, the members of social clubs, VEBAs, etc. would receive tax-free personal benefits.

Explanation of Provision

The investment income of trade associations (sec. 501(c)(6)) would be subject to the UBIT except to the extent set aside for charitable purposes, and except for gain on certain dispositions of assets used in performing exempt purposes.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
UBIT on trade association net investment income	(1)	(1)	0.1	0.1

(1) Gain of less than $50 million.

See pp. 272-274 of the Revenue Options Pamphlet (JCS-17-87).

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J. Pensions; ESOPs

1. Modify Full Funding Limitation

Present Law

Under present law, subject to certain limitations, an employer may make deductible contributions to a qualified defined benefit pension plan up to the full funding limitation. The full funding limitation is defined as the excess of (1) the accrued liability under the plan for projected benefits over (2) the plan assets. Projected benefits, unlike accrued benefits, are the benefits that are projected to be earned by normal retirement age, rather than the benefit accrued as of the close of the year.

If a defined benefit plan is terminated, the employer's liability to plan participants does not exceed the plan's termination liability (i.e., the liability for benefits determined as of the date of the plan termination). However, contributions to a plan with assets significantly in excess of termination liability may be deductible because the full funding limitation is determined on the basis of projected benefits.

Explanation of Provision

A contribution to a defined benefit pension plan would not be deductible to the extent that (1) it exceeds the present-law full funding limitation, or (2) after the contribution, the plan's assets exceed 150 percent of the plan's termination liability.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Modify full funding limitation	0.6	1.8	1.4	3.9

See pp. 120-121 of the Revenue Options Pamphlet (JCS-17-87).

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2. Repeal Certain Special ESOP Provisions

Present Law

Under present law, loans between a qualified pension plan and certain disqualified persons are prohibited. An exception to this rule is provided in the case of an ESOP. In addition, a bank, insurance company, and certain other lenders are permitted to exclude from gross income 50 percent of the interest received with respect to certain loans used to acquire employer securities held by an ESOP.

Under present law, higher deduction limits apply in the case of employer contributions to an ESOP than normally apply for an employer's contributions to a qualified plan. In addition, certain dividends paid on stock held in an ESOP are deductible to the extent the dividends are passed through to plan participants or used to repay a loan with which employer securities were acquired.

Present law provides special limits on contributions to an ESOP that are higher than the limits otherwise applicable to qualified plans.

Explanation of Provisions

The special rules providing an exception to the prohibited transaction rules for ESOP loans would be repealed. The special interest exclusion for a lender making a loan to an ESOP would be repealed.

The special deduction and contribution limits applicable to ESOPs would be repealed.

Effective Date

The repeal of the special deduction and contribution limits would be effective for years beginning after December 31, 1987. The repeal of the prohibited transaction exception and the special interest exclusion would be effective for transactions occurring after the date of committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal special ESOP provisions	0.1	0.2	0.2	0.5

See pp. 124-6 of the Revenue Options Pamphlet (JCS-17-87).

K. Other Revenue Provisions

1. Denial of Targeted Jobs Tax Credit in Certain Labor Disputes

Present Law

There is no provision in present law specifically disallowing the targeted jobs tax credit to an employer when members of a targeted group, who otherwise qualify under section 51, are hired to perform employment services in a labor dispute situation.

Explanation of Provision

Under the provision, an employer would not be entitled to the targeted jobs tax credit with respect to certain wages if the employer's plant or facility is involved in a strike or lockout. Specifically, the credit would not be available for wages paid to a targeted-group individual who performs the same or substantially similar services as those of employees participating in or affected by the strike or lockout.

Effective Date

This provision would apply to amounts paid or incurred on or after January 1, 1987 for services rendered on or after such date.

Budget Effect

[Fiscal years, billions of dollars]

	1988	**1989**	**1990**	**1988-90**
Denial of TJTC in certain labor dispute situations	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million

2. Taxation of Irrigation Subsidies

Present Law

The Federal government makes available to certain taxpayers water from reclamation and irrigation projects for agricultural purposes at less than full cost, pursuant to the Reclamation Reform Act of 1982. The difference between the full cost of the water and the amount charged the taxpayer is not considered an item of income for Federal income tax purposes.

Explanation of Provision

The excess of the full cost charge (as determined under the Reclamation Reform Act of 1982) plus any operation, maintenance, or replacement charges, over the amount required to be paid for such water, would be included in the income of the taxpayer. No deduction would be allowed for any amount included in income under this provision. The provision would apply to water made available for agricultural purposes from the operation of any reclamation or irrigation project referred to in paragraph (8) of section 202 of the Reclamation Reform Act of 1982.

Effective Date

The provision would be effective for water delivered to the taxpayer after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Taxation of irrigation subsidies	0.1	0.1	0.2	0.4

3. Expenditures Incurred in Connection with Criminal Activities

Present Law

Under present law, no deduction or credit is allowed for expenditures incurred in connection with illegal trafficking in certain drugs. The disallowance does not apply to expenses that are included in cost of goods sold.

Explanation of Provision

The disallowance of deductions and credits would be extended to expenditures incurred in connection with any activity that is subject to criminal prosecution under Federal law or the law of any State in which the activity is conducted.

Effective Date

The provision would apply to amounts paid or incurred on or after the date of enactment.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Criminal expenditures	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

4. Federal Unemployment Tax Act (FUTA): Index Wage Base

Present Law

The minimum net FUTA tax imposed on employers is 0.8 percent of the first $7,000 of wages paid to each employee during the year. The gross FUTA tax rate is 6.2 percent, but employers in States meeting certain Federal requirements and having no delinquent Federal loans are eligible for a 5.4-percent credit.

Explanation of Provision

The $7,000 limit on wages subject to the FUTA tax would be indexed to reflect the annual increase in average wages. In order to allow States time to make the required conforming changes, the proposal would be effective for years after 1988.

Effective Date

The provision would be effective January 1, 1989.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Index FUTA wage base (effective January 1, 1989)	--	0.2	0.6	0.8

See p. 76 of the Revenue Options Pamphlet.

5. Limitation on Issuance of Tax-Exempt Bonds by Indian Tribes

Present Law

Indian tribal governments in general are treated like State governments under the Internal Revenue code; however, tribal governments may issue tax-exempt bonds only for "essential governmental purposes." They may not issue private activity bonds.

IRS regulations define "essential governmental purposes" to include projects for which federal assistance could be provided under the terms of legislation governing federal assistance to Indian tribes. These regulations have permitted issuance of tax-exempt bonds for the acquisition of off-reservation enterprises. (Such issuance may, however, violate the arbitrage provisions of the 1986 Act preventing the issuance of tax-exempt bonds for investment-type property.)

Explanation of Provision

The authority of Indian tribes to issue tax-exempt bonds would be expressly limited to those purposes, other than private activity bonds, for which tax-exempt bonds generally are issued by State or local governments.

Effective Date

The provision would apply to bonds issued after date of Committee action.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit Indian bonds to purposes similar to those of State or local governments	*	*	*	0.1

*/ Gain of less than $50 million.

6. Limit on Issuance of Tax-Exempt Bonds to Acquire Existing Output Facilities

Present Law

State and local governments may issue tax-exempt bonds to finance the construction of publicly owned and operated output facilities such as electric generating and transmission systems and gas distribution systems. These governments may also use tax-exempt bonds to acquire the existing assets of investor-owned utilities including nuclear plants which may never be placed in service.

Explanation of Provision

The use of tax-exempt bonds directly or indirectly to acquire the assets of or interests in existing output facilities, within the meaning of Code section 141(b)(4) would be subject to the private activity bond volume cap.

Effective Date

The provision would be effective for bonds issued after October 13, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Limit the use of tax-exempt bonds to require existing output facilities	*	*	*	0.1

*/ Gain of less than $50 million.

III. COMPLIANCE PROVISIONS

A. Withholding

Present Law

Under present law, wages and many pension payments are subject to income tax withholding. Most other payments are not generally subject to withholding.

Explanation of Provisions

Provision 1

Withholding would be imposed at a 10-percent rate on income from stocks, bonds, and royalties.

Provision 2

Withholding would be imposed at a 10-percent rate on payments to independent contractors, parallel to withholding on wages paid to employees.

Provision 3

Withholding would be imposed on partners' shares of income from publicly offered partnerships (including those required to file a notice under applicable securities rules) and on royalties.

Effective Date

Provisions 1 and 2 would be effective on January 1, 1988. Provision 3 would be effective for partnership taxable years beginning after December 31, 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Provision 1	1.9	0.3	0.3	2.5
Provision 2	0.6	0.6	0.7	2.0
Provision 3	0.1	(1)	(1)	0.1

See pp. 255 and 192 of the Revenue Options Pamphlet (JCS-17-87).

(1) Gain of less than $50 million.

B. Escheat of Refunds

Present Law

Some taxpayers may not claim their tax refunds for a variety of reasons. Although under present law unclaimed refunds remain in the General Fund of the Treasury, no provision of the Code requires that unclaimed Federal tax refunds escheat (revert) to the Federal Government. Some States have sued the Federal Government, asserting that unclaimed Federal tax refunds escheat to the State. If the States win these cases, the Federal Government would be required to pay these amounts out of the General Fund of the Treasury to the States.

Explanation of Provision

The Code would be amended to require that unclaimed Federal tax refunds remain in the General Fund of the Treasury.

Effective Date

This provision would be effective on the date of enactment.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Escheat of refunds	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

C. IRS Funding for Better Compliance

Present Law

The President's Budget Proposal for fiscal year 1988 recommended that $5,071,850,000 in spending authority be made available for the Internal Revenue Service. This would be an increase of $584,058,000 over the President's request for fiscal year 1987 (including supplemental appropriations for retirement contributions). The Treasury, Postal Service and General Government Appropriations Act, 1988 (passed by the House on July 15, 1987) provides the same amount to the IRS as does the President's Budget Proposal, except that it also provides an additional $55 million for taxpayer services.

The Budget Resolution for fiscal year 1988 recommends additional funding above the freeze level of $547 million for the IRS, targeted to increased audit, compliance, and investigation efforts. The report of the Committee on the Budget states that these increased amounts are estimated by CBO to increase revenues by $1.85 billion in 1988, and $14 billion between 1988 and 1992.

Explanation of Provision

A Sense of the Congress Resolution would be included, stating that the IRS should be one of the first Federal agencies to utilize the new Gramm-Rudman option of a two-year budget cycle. Also, the IRS would be mandated to study the extent of the tax gap and the measures that could be undertaken to decrease the tax gap. The study would be required to utilize more current data than has been utilized recently.

It would be possible to increase the level of IRS funding in a number of specific areas. The increases would be targeted to taxpayer service, including increasing assistance to taxpayers by mail, by telephone, and in person. The increases would also be targeted to examination, collection, appeals, criminal enforcement, and foreign enforcement. All of these increases would be targeted to improving taxpayer compliance.

Effective Date

The increases would be effective on October 1, 1987 (the first day of fiscal year 1988).

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Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
IRS Funding	--	--	--	--

D. Tax Shelter Settlement Offer

Present Law

The IRS may negotiate with a taxpayer prior to or during the course of litigation to compromise the amount of taxes and penalties owed. The IRS generally does so based on the merits of the taxpayer's specific case and the hazards of litigation.

Explanation of Provision

The IRS would be required to offer to settle "tax shelter" cases. Taxpayers could choose either to accept the offer or to continue to litigate their cases.

For tax deficiencies related to taxable years ending during the period 1981 through 1985, the IRS would be required to offer investors in tax shelters the opportunity to settle for 50 percent of the assessed tax deficiency and interest, without any penalties. For deficiencies assessed for taxable years ending prior to January 1, 1981, taxpayers would be allowed to settle for 100 percent of assessed tax, without any interest or penalty. The settlement proposal would not apply to taxable years ending after December 31, 1985.

Effective Date

The offer would be effective on date of enactment, and would expire for a particular taxpayer on the later of 180 days after enactment or 90 days after the issuance of a notice of deficiency.

E. Estimated Taxes

Present Law

Under present law, individuals owing income tax who do not make estimated tax payments are generally subject to a penalty. In order to avoid the penalty, individuals must make quarterly estimated tax payments that equal at least the lesser of 100 percent of last year's tax liability or 90 percent of the current year's tax liability. Amounts withheld from wages are considered to be estimated tax payments. The size of any increase in income in the current year over the previous year is irrelevant in computing the 100 percent safe harbor.

Explanation of Provision

The safe harbor of 100 percent of the previous year's liability would not be available to taxpayers whose income in the current is at least $10,000 more than the income of the previous year.

Effective Date

The provision would be effective on the date of enactment.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Estimated tax safe harbor	0.3	0.1	0.1	0.5

IV. EXCISE TAX PROVISIONS

A. Alcoholic Beverage Excise Taxes

Present Law

Excise taxes are levied on the production or importation of the three major types of alcoholic beverages: distilled spirits, wine, and beer. The excise tax on distilled spirits is $12.50 per proof gallon; the excise tax on beer is $9.00 per barrel ($7.00 per barrel for certain small producers). The tax on wine varies with alcohol content, with the tax on still wines being $0.17 per wine gallon (up to 14% alcohol), $0.67 per wine gallon (14-21% alcohol), and $2.25 per wine gallon (21-24% alcohol). Champagne and sparkling wines are taxed at $3.40 per wine gallon, and artificially carbonated wines are taxed at $2.40 per wine gallon. Artifically carbonated wines are taxed at $2.40 per wine gallon, and champagne and other sparkling wines are taxed at $3.40 per wine gallon.

Explanation of Provisions

1. The excise tax rates for beer and all wine products would be increased by 10 percent.

2. The present excise tax rates for all taxable alcoholic beverages would be indexed to the CPI.

3. The present excise tax rate on distilled spirits and the rates on beer and wine (as increased in provision 1.) would be indexed to the CPI.

Effective Dates

The provisions would be effective on January 1, 1988, except that indexing for beer and wine tax rates under 3., above, would be effective on January 1, 1989.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
1. Beer and wine taxes increased by 10%	0.1	0.2	0.2	0.4
2. Index current alcohol taxes	0.1	0.3	0.5	0.9
3. Index alcohol taxes after 10% increase in beer and wine taxes	0.1	0.2	0.4	0.8

See pp. 35-38 of the Revenue Options Pamphlet (JCS-17-87).

B. Excise Taxes on Cigarettes and Other Tobacco Products

Present Law

Excise taxes are imposed on cigarettes and smokeless tobacco (chewing tobacco and snuff) manufactured in or imported into the United States. The tax on small cigarettes (those weighing no more than 3 pounds per thousand) is $8 per thousand (16 cents per pack of 20 cigarettes). Generally, the rate of tax on large cigarettes (those weighing more than 3 pounds per thousand) is $16.80 per thousand, except that proportionately higher rates apply to large cigarettes that exceed 6.5 inches in length.

The tax on chewing tobacco is 8 cents per pound, and the tax on snuff is 24 cents per pound. Substantially all the revenue is from the tax on small cigarettes.

Explanation of Provisions

1. The tax on small cigarettes would be increased by 8 cents per pack (total of 24 cents per pack), with a proportionately higher rate for large cigarettes.

2. The tax on small cigarettes would be increased by 10 cents per pack (total of 26 cents per pack), with a proportionately higher rate for large cigarettes.

3. The tax rates on cigarettes and smokeless tobacco would be indexed to the CPI, based on current tax rates.

4. The tax rates on cigarettes and smokeless tobacco would be indexed to the CPI, based on the increased cigarette tax rates in provisions (1) and (2) above.

Effective Date

In general, the provisions would be effective on January 1, 1988. Indexing of the cigarette tax rates under Provision 4 would be effective on January 1, 1989.

Budget Effect

(Fiscal Years, Billions of Dollars)

	1988	1989	1990	1988-90
(1) 24-cent cigarette tax	1.2	1.6	1.6	4.3
(2) 26-cent cigarette tax	1.5	2.0	1.9	5.3
(3) Index existing tobacco tax rates	0.1	0.2	0.4	0.7
(4) Index tobacco taxes at higher cigarette rates				
(a) 24-cent rate	--	0.1	0.3	0.5
(b) 26-cent rate	--	0.1	0.3	0.5

See pp. 39-41 of the Revenue Options Pamphlet (JCS-17-87).

C. Telephone Excise Tax: Increase to 4 Percent

Present Law

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service. The tax is scheduled to expire after December 31, 1987.

Explanation of Provision

The telephone excise tax would be 4-percent for 1988-1990, after which it would expire. (The Ways and Means Majority Caucus has already approved a 3-year extension of the current 3-percent rate.)

Budget Effect

(Fiscal Years; Billions of Dollars)

	1988	1989	1990	1988-90
4% telephone tax for 1988-90 (additional 1% over 3% extension already adopted)	0.4	0.8	0.8	2.0

See pp. 42-44 of the Revenue Options Pamphlet (JCS-17-87).

D. Motor Fuels Excise Taxes

1. Increase in Gasoline Tax Rate

Present Law

A tax of 9 cents per gallon is imposed on gasoline. Amounts equivalent to the revenues from this tax are deposited in the Highway Trust Fund.

A 6-cents-per-gallon exemption from the tax is provided for certain alcohol fuels mixtures ("gasohol").

Explanation of Provision

The gasoline tax would be increased by 9 cents per gallon, to 18 cents per gallon. The gasohol exemption would remain at 6 cents per gallon.

Effective Date

The provision would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
9 cents per gallon increase in gasoline tax	5.3	6.8	6.6	18.7

See pp. 63-65 of the Revenue Options Pamphlet (JCS-17-87).

2. Increase Motor Fuels Tax Rates to Fund Strategic Petroleum Reserve Program

Present Law

Excise taxes are imposed on gasoline, diesel fuel, and special motor fuels to fund the Highway Trust Fund, the Leaking Underground Storage Trust Fund (LUST Fund), and the Airport and Airway Trust Fund. The Highway Trust Fund portion of these taxes is 9 cents per gallon on gasoline and special motor fuels and 15 cents per gallon on diesel fuel. The LUST Fund rate is 0.1 cent per gallon on all three fuels. (The LUST Fund tax applies to nonhighway uses, including use in rail transportation and aviation). The Airport and Airway Trust Fund taxes are 12 cents per gallon on gasoline and 14 cents per gallon on other aviation fuels.

Explanation of Provision

The present motor fuels taxes would be increased by 1 cent per gallon, with the additional 1 cent per gallon tax applying to all uses subject to the LUST Fund tax.

Revenues equivalent to the 1 cent per gallon increase would be deposited in a new Strategic Petroleum Trust Fund, to be used for acquisition and storage of petroleum products as part of the national strategic petroleum reserve program.

Effective Date

The increase in the motor fuels tax rates and the new Strategic Petroleum Reserve Trust Fund would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Increase of 1-cent/gal. in motor fuels tax rates	0.7	1.0	1.0	2.6

See pp. 63-65 of the Revenue Options Pamphlet (JCS-17-87).

3. Collection of Gasoline Tax at Refinery Gate and Acceleration of Deposit Periods

Present Law

Point of collection.--Effective after December 31, 1987, the gasoline excise tax will be imposed on the removal of the gasoline (or a gasoline blend stock) from the refinery, or upon its removal from customs custody. An exception permits bulk transfers to bonded terminals without payment of tax. In such cases, terminal operators are liable for payment of the tax upon removal of the gasoline from the terminal. Until January 1, 1988, the tax is imposed on the sale of the product by the producer, defined to include a registered wholesale dealer.

Deposit of tax.--Persons liable for payment of the gasoline excise tax must make deposits with respect to semi-monthly periods, with the tax generally being payable nine days after the end of each semi-monthly period. A special rule permits quarterly payments in the case of certain small taxpayers.

Explanation of Provisions

1. Point of collection.--The gasoline excise tax would be imposed on removal of the gasoline (or a gasoline blend stock) from the refinery or upon its entry into customs custody.

2. Deposit of tax.--Persons liable for payment of the gasoline excise tax would be required to make deposits with respect to weekly periods, with the tax being payable on the last day of the weekly payment period, and with electronic transfer of payments being required.

Effective Date

The provisions would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Point of collection	0.2	(1)	(1)	0.2
Deposit of tax	0.3	(1)	(1)	0.3

See pp. 66-67 of the Revenue Options Pamphlet.

(1) Gain of less than $50 million.

4. Collect Diesel Fuel and Special Motor Fuels Taxes on Sales to Retailer

Present Law

The diesel fuel and special motor fuels excise taxes generally are imposed on the sale of the taxable fuel by a retail dealer to the ultimate consumer of the fuel. Under an exception, retail dealers may elect to have wholesale distributors collect and pay the diesel fuel tax when the fuel is sold to the retailer.

Explanation of Provision

The election to collect the diesel fuel excise tax on sales by wholesale dealers would be made mandatory for all sales. The special motor fuels excise tax likewise would be imposed on sale of the fuel by a wholesale distributor.

Effective Date

The provision would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Collect diesel fuel and special motor fuels tax on sales to retailer	0.2	0.2	0.2	0.6

See pp. 66-67 of the Revenue Options Pamphlet (JCS-17-87).

E. Oil Import Tax; Petroleum Tax

1. Oil Import Tax

Present Law

Superfund tax on petroleum

A tax of 8.2 cents per barrel of domestic crude oil and 11.7 cents per barrel of imported petroleum products is imposed on the receipt of crude oil at a U.S. refinery, the import of petroleum products and, if the tax has not already been paid, on the use or export of domestically produced oil.

A GATT panel convened to investigate the differential petroleum tax rate concluded that it is contrary to the GATT, and the panel ruling was accepted unanimously by the GATT Council on June 17, 1987.

Tariff on imported petroleum

Under present law, a tariff of 0.125 cent per gallon is imposed on crude petroleum, topped crude petroleum, shale oil, and distillate and residual fuel oils derived from petroleum, with low density (under 25 degrees A.P.I.). For substances with higher densities (testing 25 degrees A.P.I. or more), the tariff is 0.25 cent per gallon. (Imports from certain communist countries are subject to a 0.5 cent per gallon tariff, regardless of density.)

Explanation of Provision

An excise tax would be imposed on imported petroleum and refined products equal to the excess of $24 per barrel over the weighted average price of imported crude oil on all imported crude and refined petroleum products. A refund or credit would be provided for petroleum products used in agriculture, in the manufacture of products for export, and for home heating.

Effective Date

The provision would be effective for petroleum and refined petroleum products imported after 1987.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Oil import tax	5.5	6.0	4.7	16.2

See p. 59-62 of the Revenue Options Pamphlet (JCS-17-87).

2. Broad-Based Petroleum Tax

Present Law

Superfund taxes of 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported petroleum products are imposed on the receipt of crude oil at a U.S. refinery, the import of petroleum products and, if the tax has not already been paid, on the use or export of domestically produced oil.

Domestic crude oil subject to tax includes crude oil condensate and natural gasoline, but not other natural gas liquids. Taxable crude oil does not include oil used for extraction purposes on the premises from which it was produced, or synthetic petroleum (e.g., shale oil, liquids from coal, tar sands, biomass), or refined oil.

Petroleum products which are subject to tax upon import include crude oil, crude oil condensate, natural and refined gasoline, refined and residual oil, and any other hydrocarbon product derived from crude oil or natural gasoline which enters the United States in liquid form.

Explanation of Provision

The Superfund taxes on domestic and imported crude oil and petroleum products would be increased by $2 per barrel, with receipts from the increased tax being deposited in general revenues.

Effective Date

The provision would be effective January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Increase in petroleum tax	5.8	8.2	8.3	22.3

See pp. 57-58 of the Revenue Options Pamphlet (JCS-17-87).

3. Increase Tax on Petroleum and Repeal Windfall Profit Tax

Present Law

Superfund taxes of 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported petroleum products are imposed on the receipt of crude oil at a U.S. refinery, the import of petroleum products and, if the tax has not already been paid, on the use or export of domestically produced oil.

An excise tax is imposed on the windfall profit element of the price of domestically produced crude oil when it is removed from the premises on which it was produced. The windfall profit is defined as the excess of the sale price over the sum of the adjusted base price plus the applicable State severance tax adjustment. The tax rates and recent base prices applicable to taxable crude oil are as follows:

Category of oil	Tax rate (percent)	Base price[1] ($/barrel)
Tier-1 Oil (oil not in tiers 2 or 3)		
Integrated producer	70	$18.84
Independent producer	50	19.44
Tier-2 Oil (stripper and petroleum reserve)		
Integrated producer	60	21.99
Independent producer[2]	30	NA
Tier-3 Oil		
Newly discovered oil[3]	22.5	28.54
Incremental tertiary oil	30	28.07
Heavy oil	30	23.91

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[1] Estimate for third quarter of 1987.
[2] Independent producer stripper well oil is exempt from tax.
[3] Rate phases down to 20 and 15 percent in 1988 and 1989.

The tax is scheduled to phase out over a 33-month period beginning no later than January 1991.

Explanation of Provision

The Superfund taxes on imported crude oil and petroleum products would be increased by $0.20 per barrel, with receipts from the increased tax being deposited in general revenues. The windfall profit tax would be repealed.

Effective Date

The provision would be effective January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Increase in petroleum tax and repeal of windfall profit tax	0.4	0.6	0.6	1.7

See pp. 57-58 of the Revenue Options Pamphlet (JCS-17-87).

F. Excise Tax on Imported and Domestic Coal

Present Law

Coal tax

Domestic coal mine operators are taxed on coal production. Receipts from the tax are credited to the Black Lung Disability Trust Fund and are used to fund benefit payments to eligible coal miners. The current tax rates on domestic coal are $1.10 per ton on coal from underground mines, and $0.55 per ton on coal from surface mines. The tax is not to exceed 4.4 percent of the price of the coal when sold by the producer.

Petroleum tax

Superfund taxes of 8.2 cents per barrel for domestic crude oil and 11.7 cents per barrel for imported petroleum products are imposed on the receipt of crude oil at a U.S. refinery, the import of petroleum products and, if the tax has not already been paid, on the use or export of domestically produced oil.

Explanation of Provision

An additional excise tax would be imposed on domestic and imported coal of $0.05 per short ton of coal.

The tax on imported coal is to be determined by multiplying the tax rate ($0.20 per barrel of oil) on imported oil (see next paragraph) by the ratio of the BTU content of a barrel of imported oil to a short ton of imported coal, which is 26.4 percent. Domestic coal would be taxed at the same rate as imported coal. Receipts from the domestic coal tax would be credited to the Black Lung Disability Trust Fund. The tax on imported coal would be deposited in the general fund.

The tax on imported oil would be determined under the preceding proposal which also would set a uniform tax to be levied on imported and domestic oil and oil products. Revenue from the oil tax would be used to offset the revenue loss from repeal of the windfall profit tax. (See item E.3., above).

Effective Date

The provision would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Tax on imported and domestic coal	(1)	(1)	(1)	0.1

See pp. 57-58 of the Revenue Options Pamphlet (JCS-17-87).

G. Securities Transfer Excise Tax

Present Law

Under present law, no tax is imposed upon the transfer of corporate stock or any other security, other than income taxes attributable to any gain realized by the transferor. Transfer taxes were imposed, however, on transfers of certain securities from 1918 to 1965. Immediately prior to repeal in 1965, the transfer tax was imposed at a rate of 0.1 percent of value on the original issue and 0.04 percent on subsequent transfers of stock, and was imposed at a rate of 0.05 percent on the original issue and 0.05 percent on the subsequent trading of certificates of indebtedness.

Explanation of Provision

A securities transfer excise tax ("STET") would be imposed at a rate of 0.5 percent of value upon transfers of certain securities. The securities subject to the tax could include stock and debt securities, whether or not publicly traded, options, futures, forward contracts, and other items, such as limited partnership interests, that are close substitutes to the above securities.

The transfers subject to the STET would include sales or exchanges, gifts, transfers at death, transfers pursuant to divorce, transfers to a trust, transfers pursuant to mergers or acquisitions, and transfers upon issuance or redemption of a security. Special rules would apply to transactions with certain elements and to pass-through entities.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
0.5 percent securities transfer excise tax	5.0	7.5	10.0	22.5

See pp. 82-83 of the Revenue Options Pamplhlet (JCS-17-87).

H. Taxes on Sulfur Dioxide Emissions and Ozone Depleting Chemicals

1. Sulfur Dioxide Emissions Tax

Present Law

Present law does not impose an excise tax on the amount of sulfur dioxide or other pollutants discharged into the environment.

Explanation of Provisions

Provision 1--Impose an excise tax on the emission into the atmosphere of sulfur dioxide and nitrogen oxides from any boiler or furnace which is used to burn fossil fuels for steam production. The tax would be imposed at a variable rate depending on the emissions rate of the boiler or furnace.

A 25-percent income tax credit, earned ratably over 10 years would be allowed for investment in pollution control equipment.

Provision 2--Impose an excise tax only on the amount of sulfur dioxide that is discharged into the atmosphere by corporations operating large steam-generating boilers and furnaces in the United States. Emissions and the emissions rate would be calculated on a corporate-wide basis. The rate of tax imposed would increase as the corporation's average level of emissions increased. Emissions from an 80-percent owned subsidiary are allocated to the parent corporation for purposes of the tax.

No credit against income tax would be allowed for investment in pollution control equipment.

Effective Date

Both provisions would apply to emissions after December 31, 1988. Tax rates would be phased in over a 3-year period and the rates would be adjusted for inflation after 1990.

Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
Facility level tax on emissions	0.0	3.0	5.2	8.2
Corporate-level tax on sulfur dioxide	0.0	1.7	2.8	4.5

See p. 50 of the Revenue Options Pamphlet (JCS-17-87).

2. Tax on Ozone Depleting Chemicals

Present Law

Chemicals which deplete the ozone layer are not subject to tax under present law.

Explanation of Provision

An excise tax would be imposed on the sale or use by the manufacturer of ozone depleting chemicals and on the import of such chemicals, or products containing such chemicals. Ozone depleting chemicals include chlorofluorocarbons ("CFCs") which are used as refrigerants, foam blowing agents, and solvents; methyl chloroform; carbon tetrachloride; and halon. The tax rate for each ozone depleting chemical generally would be determined as $3 per pound multiplied by that chemical's ozone depletion index. (Phased-in rates would apply for 1988 and 1989.) The ozone depletion index for any chemical is its ozone depleting potential divided by the ozone depleting potential of CFC-11.

Effective Date

The provision would be effective for sales or uses of ozone depleting chemicals after 1987. Under a transition rule, the tax rate would be $1 per pound (multiplied by the ozone depletion index) for sales and uses in 1988, and $2 per pound in 1989.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Tax on ozone depleting chemicals	0.2	0.4	0.7	1.3

See pp. 51-52 of the Revenue Options Pamphlet (JCS-17-87).

106.

I. Luxury Excise Taxes

Present and Prior Law

Federal excise taxes have not been levied on a broad range of consumer items, whether or not such items could be called luxury items, since the Excise Tax Reduction Act of 1965 repealed a large number of manufacturers, wholesalers and retailers excise taxes. Among the articles subject to tax under prior law were automobiles, jewelry, and furs.

The repealed taxes were mostly levied at an ad valorem rate of 10 percent on the sales prices; there were no threshold prices above which the tax would be levied.

Explanation of Provision

Excise taxes would be imposed at a 10-percent rate on--

a. The cost of automobiles in excess of $20,000 per auto;

b. The cost of yachts and similar watercraft in excess of $10,000;

c. The cost of corporate jets and similar aircraft not used primarily in carrying passengers or cargo for hire;

d. The cost of fur coats and other articles of clothing containing fur in excess of $100 per article; and

e. The cost of jewelry and precious gemstones in excess of $100.

Effective Date

The provision would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Impose tax on --				
a) 10% taxes on value of autos in excess of $20,000	0.3	0.4	0.4	1.2
b) 10% tax on value of yachts, etc., in excess of $10,000	0.1	0.1	0.1	0.3
c) 10% tax on private aircraft	0.2	0.3	0.3	0.8
d) 10% tax on value of furs in excess of $100	0.1	0.1	0.1	0.2
e) 10% tax on value of jewelry and precious gemstones in excess of $100	0.2	0.4	0.4	1.1

See pp. 45-47 of the Revenue Options Pamphlet (JCS-17-87).

J. Gas Guzzler Excise Tax

Present Law

Under present law, an excise tax is imposed on automobiles that do not meet statutorily specified fuel economy standards. The amount of the tax varies according to the fuel efficiency of a particular model of automobile. For 1986 and later model year automobiles, no gas guzzler tax is imposed if the fuel economy of the automobile model is at least 22.5 miles per gallon (as determined by the Environmental Protection Agency). For automobiles not meeting that standard, the tax imposed begins at $500 per automobile and increases to $3,850 for automobile models with fuel economy of less than 12.5 miles per gallon. Some limousines, pickup trucks, vans, and the output of small manufacturers are exempt from the tax. The gas guzzler tax is imposed on the manufacturer or importer. A recent GAO report (July 16, 1987) found that, with respect to imported vehicles, the rate of noncompliance with the gas guzzler tax by independent importers was 99 percent.

Explanation of Provision

The rates of the gas guzzler tax would be doubled, compliance would be improved, and special exemptions would be eliminated.

Effective Date

The provision would be effective on January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Increase gas guzzler tax	0.1	0.1	0.1	0.2

See pp. 70-71 of the Revenue Options Pamphlet (JCS-17-87).

V. Income Tax Rates

A. Individual and Corporate Tax Rates

Present Law

Individuals

In the Tax Reform Act of 1986, tax structures for each of the four filing classifications were reduced from 14 or 15 marginal tax rates to two marginal tax rates and a phaseout range for 1988 and later years. The zero bracket amounts of prior law have been replaced by the standard deduction, which is deducted from adjusted gross income in the process of determining taxable income.

In 1988 and later years, there are 15- and 28-percent marginal tax rate brackets for each filing classification. In addition, some taxpayers will be subject to an additional 5-percent tax as taxable incomes increase within a range in which the tax benefits of the 15-percent tax rate and personal exemption deductions are phased out. The 5-percent phaseout tax rate disappears as taxable income increases above the phaseout range. Beginning in 1988, long-term capital gain will be taxed as ordinary income and will be subject to the phaseout tax rate.

Corporations

Under the Tax Reform Act of 1986, a new corporate tax rate structure became effective on July 1, 1987. This structure has a top corporate tax rate of 34 percent, which applies to taxable income in excess of $75,000. Below $75,000, a 15-percent rate applies to taxable income to $50,000, and 25 percent to $75,000. A phaseout of the 15- and 25-percent tax rates begins at taxable income above $100,000.

For taxable years that include periods when the old and new tax rate structures are effective, taxpayers will apply the two rate structures in proportion to the number of days in the taxable year that includes each of the tax structures.

Corporate net capital gain properly taken into account after December 31, 1986, is taxed at a 34-percent rate.

Explanation of Provisions

1. A five-percent surtax on individual and corporate income tax liabilities, including individual and corporate minimum tax liabilities.

2. (a) A five-percent surtax on corporate income tax liabilities (including minimum tax liabilities), and

(b) A five-percent surtax on the income tax liabilities of individuals with taxable income at or above:

(i) $50,000 joint returns/$35,000 single returns,

(ii) $60,000 joint returns/$42,000 single returns, or

(iii) $75,000 joint returns/$52,500 single returns.

3. Create a third marginal tax rate of 33 percent for individuals that would apply to taxable income at and above the level at which the phaseout of the tax benefits of the 15-percent rate bracket and personal exemptions applies.

Budget Effect

(Fiscal years, billions of dollars)

	1988	1989	1990	1988-90
Proposals:				
1. 5-percent surtax:				
Individuals	10.3	20.1	22.6	53.0
Corporations	2.9	5.3	6.0	14.3
2. 5-percent surtax:				
Corporations	2.9	5.3	6.0	14.3
Individuals, above--				
(i) $50,000/$35,000	2.0	9.2	10.8	22.0
(ii) $60,000/$42,000	1.5	7.8	9.2	18.5
(iii) $75,000/$52,500	1.0	6.6	7.9	15.4
3. Impose 33% rate on income levels above phaseout of personal exemptions	2.8	6.5	8.8	18.2

See pp. 84-87 of the Revenue Options Pamphlet (JCS-17-87).

B. Capital Gains Tax Rate

Present Law

Under present law, capital gain net income is taxed the same as ordinary income, beginning in 1988.

Explanation of Provisions

1. The maximum rate on net capital gains would be 15 percent.

2. The maximum rate on net capital gains would be 20 percent.

Effective Date

The provisions would apply to sales and exchanges after date of committee action.

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VI. ADMINISTRATION REVENUE PROPOSALS NOT PREVIOUSLY APPROVED BY WAYS AND MEANS MAJORITY CAUCUS

A. Employment Tax Provisions

1. Extend Medicare Payroll Tax to All State and Local Government Employees

Present Law

Before enactment of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), State and local government employees were covered under Medicare only if the State and the Secretary of Health and Human Services entered into a voluntary agreement providing such coverage. In COBRA, the Congress extended Medicare coverage (and the corresponding hospital insurance payroll tax) on a mandatory basis to State and local government employees hired after March 31, 1986.

For wages paid in 1987 to Medicare-covered employees, the total hospital insurance tax rate is 2.9 percent of the first $43,800 of wages; the tax is divided equally between the employer and the employee.

Explanation of Provision

The provision would extend Medicare coverage (and the corresponding hospital insurance payroll tax) on a mandatory basis to all employees of State and local governments not otherwise covered under present law, without regard to their starting dates of employment

Effective Date

This provision would be effective January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Extend Medicare payroll tax to all State-local government employees	1.3	1.9	1.9	5.2

See pp. 1-2 of the Revenue Options Pamphlet (JCS-17-87).

2. Extend FICA Tax to Student Earnings

Present Law

The social security system is financed by payroll taxes imposed under the Federal Insurance Contributions Act ("FICA"). The 1987 FICA tax rates are 7.15 percent paid by employers and 7.15 percent paid by employees on wages (up to maximum of $43,800).

An employee receives social security credit for earnings only if his or her salary constitutes wages and if his or her job is included in the definition of employment ("covered employment") under Code section 3121. The Act generally defines wages to include all remuneration for employment but provides specific exemptions, including an exemption for most wages earned by students in the employ of their school.

Explanation of Provision

The provision would eliminate the exemption from the definition of wages for certain services performed by a student in an academic setting, under which such services are excluded from coverage under social security and are not subject to FICA taxes. Students eligible for the present-law exemption include students employed by a school they are attending (or college club or an auxiliary nonprofit organization of a school) and student nurses employed by a hospital or nurses' training school they are attending.

Effective Date

This provision would be effective January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Extend FICA tax to student earnings	0.1	0.1	0.1	0.2

B. Excise Tax Provisions

1. Proposals Relating to Black Lung Benefits

a. Increase in coal excise tax

Present Law

A manufacturers excise tax is imposed on the sale or use by the producer of domestically mined coal. In COBRA, the rate of the tax was increased by 10 percent, effective April 1, 1986, to $1.10 per ton of coal from underground mines, and 55 cents per ton of coal from surface mines, subject to a cap of 4.4 percent of the sales price.

Amounts equal to the tax revenues are appropriated automatically to the Black Lung Disability Trust Fund. Present law includes an unlimited authorization for advances to the Trust Fund, generally repayable with interest, from the Treasury. However, COBRA provided a five-year moratorium on interest accruals (to October 1, 1990) with respect to such repayable advances. As of the beginning of fiscal 1987, the Trust Fund deficit--i.e., the amount of advances repayable to the general fund--was $2.9 billion.

Explanation of Provision

The provision would increase the excise tax to $1.70 per ton for coal from underground mines and $0.85 per ton for coal from surface mines, subject to a cap of 6.8 percent of the sales price. (The Administration also has proposed repeal of the five-year moratorium on interest accruals on repayable advances to the Trust Fund.)

Effective Date

The increased coal excise tax rates would be effective January 1, 1988, through December 31, 1990, with decreasing rates thereafter.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Increase in coal excise tax	0.2	0.3	0.3	0.7

See pp. 12-13 of the Revenue Options Pamphlet (JCS-17-87).

b. Inclusion of black lung cash benefits in gross income

Present Law

Title IV of the Federal Coal Mine Health and Safety Act provides for payment of monthly cash benefits to eligible coal miners who are totally disabled by black lung disease and to their survivors. Also, a coal miner receiving black lung cash benefits is eligible for related medical and rehabilitation benefits.

Under present law, black lung disability benefits are excludable from gross income as workers' compensation benefits (Rev. Rul. 72-400, 1972-2 C.B. 75).

Explanation of Provision

Under the provision, black lung cash benefits would be includible in the recipient's gross income. (The value of medical and rehabilitation benefits received by a disabled miner would continue to be excludable from income.)

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Inclusion of black lung cash benefits in gross income	0.1	0.2	0.2	0.5

See pp. 13-14 of the Revenue Options Pamphlet (JCS-17-87).

2. Repeal of Current Alcohol Fuels Exemption from Highway Excise Taxes

Present Law

Excise taxes are imposed on motor fuels, tires, and trucks and trailers, and a use tax is imposed on heavy highway vehicles. Revenues equivalent to amounts derived from these taxes are deposited in the Highway Trust Fund. These Highway Trust Fund excise taxes are scheduled to expire after September 30, 1993.

Under present law, exemptions from all or part of some of these excise taxes are provided for fuels containing alcohol, for private and public bus operators, and for State and local governments.

Explanation of Provision

The provision would repeal the exemption from Highway Trust Fund excise taxes for alcohol fuels.

Effective Date

The provision would be effective January 1, 1988.

Budget Effect

[Fiscal years, billions of dollars]

	1988	1989	1990	1988-90
Repeal alcohol fuels tax exemption	(1)	(1)	(1)	(1)

(1) Gain of less than $50 million.

See pp. 15-16 of the Revenue Options Pamphlet (JCS-17-87).